Petition

81-1836

Supreme Court, U.S.
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NO. _____

IN THE

Supreme Court of the United States

OCTOBER TERM 1981

PAUL V. WATSON and SHARON E. WATSON,
Petitioners,

v.

UNITED STATES OF AMERICA and
INTERNAL REVENUE SERVICE AGENT,
DAVID L. ACKLEY,
Respondents.

On Writ Of Certiorari To The United States Court of Appeals For The Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. May the Internal Revenue Service enforce its civil summons issued to obtain records of a third party in furtherance of an investigation pursuant to an official program of the IRS, the sole purpose of which is to gather information for criminal prosecution of the person whose records are involved for violation(s) of either Title 26 or Title 18 offenses because a revenue agent whose normal concern is with civil tax liabilities has, at the request of the Special Agent issuing the summons, been assigned to the case?

2. In an IRS summons enforcement case, may a Court of Appeals disregard the findings of a trial court that the sole institutional commitment of the IRS is criminal prosecution and substitute its own findings that the investigation was a joint investigation of both criminal and civil tax matters upon a record demonstrating that the IRS has successfully resisted discovery, sought enforcement of a summons issued pursuant to an investigation conducted in accordance with an official program the only object of which is criminal prosecution, produced only the Special Agent whose testimony was contradictory and has consciously failed to call the revenue agent who was represented by the IRS to be present in the courtroom?

LIST OF PARTIES

United States of America and Internal Revenue Service Officer, David L. Ackley, Plaintiffs-Appellees, Cross-Appellants, Respondents

University Savings Association and Emily Clark, Collection Supervisor, Defendants

Channelview Bank and James V. Morrell, Vice President, Defendants

Colonial National Bank and Robert J. Kramer, Vice President, Defendants

Texas Commerce Bank and Lee Strauss, Vice President, Defendants

Greenspoint Bank and Karen Bennett, Cashier, Defendants

Jetero Bank and Cayce W. Moore, Jr., Defendants

Wallingford, Flavin, Fox and Company, and Philip Fox, Defendants

Paul V. Watson and Sharon E. Watson, Intervenors-Appellants, Cross-Appellees, Petitioners

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III. The Court of Appeals, in conflict with the prior decisions of this Court and Federal Rules of Civil Procedure, Rule 52, incorrectly held that in an IRS summons enforcement case, it may disregard the finding of a trial court that the sole institutional commitment of the IRS is criminal prosecution and substitute its own findings that the investigation was a joint investigation of both criminal and civil tax matters upon a record demonstrating that the IRS has successfully resisted discovery, sought enforcement of a summons issued pursuant to an investigation conducted in accordance with an official program the only object of which is criminal prosecution, produced only the special agent whose testimony was contradictory and has consciously failed to call the revenue agent who was represented by the IRS to be present in the courtroom 16

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PETITION FOR WRIT OF CERTIORARI

Petitioners, Paul V. Watson and Sharon E. Watson, respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in this action on January 28, 1982.

OPINIONS BELOW

The Opinion, initial Order and Judgment of the District Court for the Southern District of Texas, Houston Division are appended to this petition in the Appendix as Items II, III and IV. The opinion of the Court of Appeals for the 5th Circuit is reported at 666 F.2d 312 and is reproduced in the Appendix hereto as Item I.

JURISDICTION

The Court of Appeals for the 5th Circuit rendered its Opinion on January 28, 1982. Petitioners timely filed a motion for rehearing on February 11, 1982 which was denied by Order dated March 10, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES, FEDERAL RULES AND REGULATIONS INVOLVED

The Statutes, Federal Rules and Regulations involved in this case are as follows:

Manual Supplement, 9G-93 Department of the Treasury Internal Revenue Service:	Reproduced in its entirety in the Appendix, Item VI
26 U.S.C. § 7602:	Reproduced in its entirety in the Appendix, Item VII
26 U.S.C. § 7609:	Reproduced in its entirety in the Appendix, Item VIII
Rule 52, F.R.C.P.:	Reproduced in its entirety in the Appendix, Item IX

STATEMENT OF THE CASE

This is an IRS summons enforcement case wherein the trial court denied enforcement upon a finding that the sole institutional commitment of the IRS was criminal prosecution and the Court of Appeals has reversed upon finding a revenue agent was assigned to the case.

The consolidated case of enforcement of the seven IRS summonses directed to third party record keepers was heard pursuant to a show cause hearing on June 17, 1980. The Taxpayer, Paul V. Watson ("Watson") had intervened alleging that Special Agent Ackley ("Ackley") did not have authority pursuant to 26 U.S.C. 7602 to serve the summonses in issue; that while the information sought may be relevant to the tax liability of Watson, the IRS was not in good faith pursuing an investigation of Watson's tax liabilities and that the investigation was being conducted pursuant to "Manual Supplement, Examination and Investigation of Illegal Tax Protest Type Activities 9G-93 ("Manual Supplement") for the sole purpose of gathering information for criminal prosecution of Watson.

The IRS called only Special Agent Ackley to testify. After cross-examination of Ackley the following occurred:

> "The Court: Let me ask you Mr. Amdur, [Government's counsel] are you going to have any further evidence?
>
> Mr. Amdur: No, your Honor. I have the civil agent here to be called, if counsel wishes to do it, but I see no need to call him.
>
> The Court: I will tell you I am not going to enforce the subpoenas. I think that it is clear that the insti-

> tutional posture of the Internal Revenue Service is that they are going to prosecute this case and that is what they started it for and that is what they are looking for and I am not going to enforce these summonses."
>
> (Tr. Vol. VIII pg. 41 L. 15-25)

The record does not reflect any written evidence of a joint investigation involving a revenue agent. The first knowledge that Watson had of the alleged existence of a revenue agent in the case was the testimony of Ackley on June 17, 1980.

The only evidence of any participation by a revenue agent was the testimony of Ackley. Ackley further testified as follows:

1. His involvement arose as a result of an audit of a partnership that reflected no returns filed by one of its members, Watson, (Tr. Vol. VIII pg. 36) yet one of the summonses in issue is directed to the accountants for the partnership and requests production of the partnership tax returns. (Tr. Vol. VIII pg. 4, pg. 9) Ackley testified he had none of the information sought by the summons. (Tr. Vol. VIII pg. 11 L. 2-9)

2. He had Revenue Agent Richard Bernard working with him (Tr. Vol. VIII pg. 13 L. 17-21) but such agent's name nowhere appears on the summonses and, in fact, Special Agent Ackley has been accompanied only by special agents in conducting the investigation of the Watsons. (Tr. Vol. VIII pg. 14 L. 21-25) In fact, the summonses which are attached as exhibits to each of the seven (7) petitions reflect that each was served by a special agent.

3. He testified the summonses were issued in part to aid in determination of the tax liability of Paul Watson and wife, Sharon Watson (Tr. Vol. VIII pg. 12 L. 6-9, pg. 28 L. 10-12); yet, the summonses themselves reflect the investigation is only as to Watson (Tr. Vol. I pg. 5, Vol. II pg. 4, Vol. III pg. 5, Vol. IV pg. 5, Vol. V pg. 5, Vol. VI pg. 4, Vol. VII pg. 4).

4. He denied using National Project Number "30"[1] in completing Form 4930 in conformity with the Manual Supplement (Tr. Vol. VIII pg. 25 L. 3-7) and would admit only that it is possible that when such form was finally completed the investigation may qualify as a National Project Number "30" investigation (Tr. Vol. VIII pg. 27 L. 23-25), yet the Administrative Summons Control Form prepared by Ackley in his own handwriting and (apparently inadvertently) attached by the Government to one of the petitions in issue specifically states in item 12 under "Program Information, Criminal Investigation Only" as opposed to "Examination Division":

"National Project Number (if applicable) 30."

5. He equivocated and refused to give a clear answer when first asked if the Manual Supplement was guiding his investigation of Watson claiming that such a question could not be answered yes or no (Tr. Vol. VIII pg. 23 L. 8-13) but finally admitted the investigation was being conducted under the Manual Supplement (Tr. Vol. VIII pg. 35 L. 23-24)

6. He initially denied using Code 166 in completing Form 4930 as provided for in the Manual Supplement

1. An Identification required by the Manual Supplement to designate investigations that have qualified to be controlled by the Manual Supplement.

to further identify investigation of illegal activity when he first received and numbered the case, but later admitted the appropriate block may have been so filled in. (Tr. Vol. VIII pg. 26 L. 19 - pg. 27 L. 8, L. 13-25)

7. During an interview of Watson, he wanted to know if Watson had mailed three documents[2] to Austin, Texas. When asked why he had made such an inquiry, Ackley replied:

> "Ans.: Because there are two different jurisdictions and venue could lie in the Western or Southern Judicial District depending on where he filed them from and where he mailed them to."[3]
>
> Question: Venue?
>
> Ans.: Right."
>
> (Tr. Vol. VII pg. 30 L.17 - pg. 31 L.15)

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2. The three documents were purported federal tax returns which resulted in the classification of Watson as an illegal tax protestor and which Watson believes actually triggered the investigation rather than an audit of a partnership. (Tr. Vol. VIII pg. 15 L. 9-22, pg. 16 L. 22-25)

3. 18 U.S.C. 1341 generally provides that it is a felony offense to use the U.S. mail in any scheme to defraud and the statute is used in the prosecution of tax cases. *United States v. Miller*, 545 F.2d 1204 (9th Cir. 1976). Venue for purposes of 18 U.S.C. 1341 could be in the Southern District of Texas which includes Houston, Texas from where the documents were mailed or the Western District of Texas which includes Austin, Texas where the Office of the District Director, I.R.S. is located and to whom the documents were mailed. *U.S. v. McGregor*, 503 F.2d 1167 (8th Cir. 1974), 18 U.S.C. 3237a; and such choice of venue is available in the instant case if coupled, for example, with the offense of Statements and Entries Generally, 18 U.S.C. 1001 or Conspiracy to Commit Offense or to Defraud United States, 18 U.S.C. 371 as recommended in the Manual Supplement at pg. 7, Sec. 6.02-1063 and 4. On the other hand, generally venue for offenses under the Internal Revenue Code, even when coupled with the offense of use of the U.S. mail 18 U.S.C. 1341, is the judicial district in which the defendant resides and in the instant case would be the Southern District of Texas. 18 U.S.C. 3237(b)

On July 7, 1980, the trial court entered an Order finding the then institutional posture of the IRS to be solely for the criminal prosecution of Watson, but observing the IRS could change its posture. (Tr. Vol. I pg. 72)

The response of the IRS was to file two additional summons enforcement cases involving Watson seeking to relitigate the same fact issue before another trier of fact. (Tr. Vol. I pg. 84-92 pg. 114-123)

At no time did the IRS seek in any manner to corroborate the testimony of Ackley as to the existence of a revenue agent: they did not call the revenue agent to the stand, did not request further evidentiary hearing, file an affidavit, offer a document reflecting involvement of a revenue agent or do any act to support the testimony.

Five and one-half months after the hearing, the trial court on December 9, 1980 entered its Memorandum and Order observing that the IRS had unsuccessfully contended it was involved in a joint civil and criminal investigation on June 17, 1980 and as it elected not to respond further, the Court would enter judgment accordingly (Tr. Vol. I pg. 131) which it did on January 13, 1981 dismissing the petitions on the merits.

The Court of Appeals, while finding that Special Agent Ackley was following the procedures as set out in the Manual Supplement and that the procedures relate only to criminal investigation, has determined that the summonses are enforceable because the investigation pertains to both the civil and criminal tax liabilities of Watson. Opinion pg. 816. Specifically, the Panel held:

> "That the uncontroverted evidence on this issue was the testimony of the special agent that he was con-

ducting a joint investigation with the assistance of a revenue agent of the Examination Division to determine the taxpayers correct tax liability and to determine whether evidence of any tax crimes existed."

Opinion pg. 817

I.

SUMMARY OF ARGUMENT

The questions presented by this case are of great and recurring significance to taxpayers generally and to the administration of the internal revenue laws. The opportunity of a taxpayer to contest the discovery of writings pertaining to him in the possession of third persons which are intended to be used against him in a criminal prosecution exists only through contesting the enforcement of the summons as this Court has effectively negated any other objection based upon unlawful acquisition by the government of writings of another pertaining to a taxpayer. *United States v. Payner*, 447 U.S.____, 100 S.Ct. 2439, 65 L.Ed.2d ____ (1980).

(a) The Court of Appeals, in conflict with a decision of this Court, has used a bright line test to determine that an IRS summons issued in an investigation that is criminal only is enforceable because a revenue agent has been assigned, without regard to participation, to the case.

The decision below should be reviewed because it erroneously employs a bright line test (previously rejected by this Court) for the enforcement of an IRS summons issued by a Special Agent of the IRS in holding that although the investigation was being conducted pursuant to an official IRS program which was solely for the purpose of criminal investigation, since the Special Agent

testified that he had requested the assignment of a revenue agent to the case to investigate the civil tax liability of the taxpayer, the summons was enforceable. In the alternative, the case demonstrates that the abusive use of the IRS summons as a tool solely for gathering information for a criminal prosecution prior to a recommendation by the IRS to the Department of Justice for criminal prosecution may not be as remote as this Court anticipated in *United States v. LaSalle National Bank*, 98 S.Ct. 2357, 57 L.Ed.2d 221, 437 U.S. 298 (1978) and that further guidelines are required from this Court concerning the use of the IRS summons where the institutional commitment to prosecute is demonstrated by an official program of the IRS but by the expediency of having the Special Agent testify that he has requested a revenue agent to investigate the civil tax liability, the limitations on use of the IRS summons set forth in LaSalle, and the good faith test announced by this Court in *Donaldson v. United States*, 400 U.S. 517, 91 S.Ct. 534, 27 L.Ed.2d 580 (1971); *United States v. Powell*, 379 U.S. 48, 85 S.Ct. 248, 13 L.Ed.2d 112 (1964) are avoided.

(b) As IRS summons enforcement proceedings are summary, it is crucial to the rights of all taxpayers to determine the standard of review of findings by a trial court in such proceedings.

The decision should be reviewed because it erroneously establishes in conflict with this Court's decision in *United States v. United States Gypsum Co.*, 333 U.S. 364, 68 S.Ct. 525, 92 L.Ed.2d 746 (1948), a separate standard for review of fact findings by a trial court in review of a judgment adverse to the United States and purports to authorize a court of appeals to substitute its own findings

of fact for those of the trial court yet fails to define the quantum of evidence required in a summons enforcement case.

II.

THE COURT OF APPEALS, IN CONFLICT WITH PRIOR HOLDINGS OF THIS COURT, HAS INCORRECTLY HELD THAT THE INTERNAL REVENUE SERVICE MAY ENFORCE ITS CIVIL SUMMONS ISSUED TO OBTAIN RECORDS OF A THIRD PARTY IN FURTHERANCE OF AN INVESTIGATION PURSUANT TO AN OFFICIAL PROGRAM OF THE IRS, THE SOLE PURPOSE OF WHICH IS TO GATHER INFORMATION FOR CRIMINAL PROSECUTION OF THE PERSON WHOSE RECORDS ARE INVOLVED FOR VIOLATION(S) OF EITHER TITLE 26 OR TITLE 18 OFFENSES BECAUSE A REVENUE AGENT WHOSE NORMAL CONCERN IS WITH CIVIL TAX LIABILITIES HAS, AT THE REQUEST OF THE SPECIAL AGENT ISSUING THE SUMMONS, BEEN ASSIGNED TO THE CASE.

In *Donaldson v. United States, supra*,[4] this Court stated that an IRS summons may be used:

> ". . . if it is issued in good faith and prior to a recommendation for criminal prosecution."
> 400 U.S. at 567, 91 S.Ct. at 545

The concept of a bright line test to the effect that an IRS summons was valid so long as there had been no

4. The actual holding was that a taxpayer had no right to intervene in a third party IRS summons. 26 U.S.C. 7609 now specifically authorizes a taxpayer to intervene as a matter of right in a summons issued to another for records of the taxpayer.

recommendation by the IRS to the Department of Justice was specifically rejected by this Court in *United States v. LaSalle National Bank, supra.* Rather, this Court affirmed that the summons must be issued before a recommendation to the Department of Justice and that the IRS must meet the good faith standard required by *United States v. Powell, supra,* to the effect that:

> "[The Service] must show that the investigation will be conducted pursuant to a legitimate purpose . . .
>
> * * *
>
> A Court may not permit its process to be abused. Such an abuse would take place if the summons had been issued for an improper purpose, such as to harass the taxpayer or to put pressure on him to settle a collateral dispute or for any other purpose reflecting on the good faith of the particular investigation."
>
> 379 U.S. at 57-58, 85 S.Ct. at 254-255

In *United States v. LaSalle National Bank, supra,* the concept that an IRS summons could be used solely for a criminal investigation as argued by the dissenting opinion therein was expressly rejected and this Court noted:

> "Congress therefore, intended the summons authority to be used to aid the determination and collection of taxes. These purposes do not include the goal of filing criminal charges against citizens. Consequently, summons authority does not exist to aid criminal investigations solely."
>
> Footnote 18, 437 U.S. at 317, 98 S.Ct. at 2367

In the instant case, it is without question that the summons has been issued in furtherance of an investigation

pursuant to Manual Supplement 9G-93, January 10, 1979 ("Manual Supplement"). The Manual Supplement states on page one that:

> "The purpose of these procedures is to further the total service objectives of encouraging and achieving the highest degree of voluntary compliance with the tax laws *by* enforcing statutory sanctions." (emphasis added)

The Court of Appeals has correctly determined that the Manual Supplement relates only to a criminal investigation. Opinion pg. 816

And the Manual Supplement demonstrates the institutional commitment by the IRS to criminally prosecute. It is not limited to crimes under Title 26 U.S.C. such as Section 7201 - Attempt to Evade or Defeat Tax, Section 7203 - Willful Failure to File Return, or Section 7206 - Fraud and Fake Statements, but as the Court of Appeals observes, relates as well to several offenses under Title 18 U.S.C. including among others Section 2 - Principles, Section 371 - Conspiracy to Commit Offense or Defraud the United States and Section 1001 - Statements of Entries Generally. And as it reflects, it is concerned not with a collecting of taxes, but rather the program contained therein is concerned only with the number of criminal convictions, jail time, fines and probations. (Appendix Item VI).

But the Court of Appeals while finding that the Special Agent was pursuing only a criminal investigation[5] holds the summons enforceable because:

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5. The language of the Appellate Court's Opinion at pg. 517 to the effect that "Because Special Agent Ackley, himself, was pursuing a criminal investigation only." cannot be read as referring to an

> "The uncontroverted evidence on this issue was the testimony of the Special Agent that he was conducting a joint investigation with the assistance of a revenue agent . . . to determine the taxpayers correct tax liability and to determine whether evidence of any tax crimes existed."[6]
>
> Opinion pg. 817-818

In *United States v. LaSalle National Bank, supra,* this Court observed:

> "We shall not countenance delay in submitting a recommendation to the Justice Department when there is an institutional commitment to make the referral and the Service merely would like to gather additional evidence for the prosecution. Such a delay would be tantamount to the use of the summons authority after the recommendation and would permit the Government to expand its criminal discovery rights. Similarly, the good-faith standard will not permit the IRS to become an information-gathering agency for other departments, including the Department of Justice, regardless of the status of criminal cases.
>
> 98 S.Ct. at 2367-2368

Such language appeared to make clear that an IRS summons could not be used to gather information solely for a criminal investigation. The conclusion is buttressed by this Court's observation in the same case that:

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opinion held by Special Agent Ackley because he consistently asserted the investigation and summons in aid thereof were to determine tax liability of the taxpayer. (Tr. Vol. VIII pg. 12 L. 6-9, pg. 28 L. 10-12)

6. Watson contends the evidence was controverted and the Court of Appeals has erred in reversing the trial court on this point as discussed in Question No. 2 hereof.

> "Logically, then, the IRS could use its summons authority under § 7602 to uncover information about the tax liability created by a fraud regardless of the status of a criminal case. But the rule forbidding such is a prophylactic intended to safeguard the following policy interests."[7]
>
> 437 U.S. at 313, 98 S.Ct. at 2365

Hence, this Court held in *LaSalle* that where the summons is issued prior to a recommendation to the Department of Justice, it must be issued in good faith.

Here, the Court of Appeals holds that though the instant investigation under the Manual Supplement is criminal only, Watson has failed to prove that the investigation does not have a valid civil tax determination purpose.

The holding below appears to beg the issue as to whether it can be said that the IRS has discharged its burden to show that the summons has been issued in good faith in pursuit of a legitimate purpose.

To gather information for a criminal prosecution for a Title 18 offense does not appear to be related to the enforcement of the revenue laws. 26 U.S.C. 7601(a)

Even to the extent that the Manual Supplement is concerned with Title 26 criminal offenses, the summons remains unrelated to an investigation with a legitimate purpose which this Court has held to be:

> ". . . a valid civil tax determination or collection purpose by the Service."
>
> 437 U.S. at 317, 98 S.Ct. at 2367

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7. This Court, in effect, stated the policy interests to be an impermissible expansion of criminal discovery rights of the Justice Department and infringement on the role of the grand jury.

While this Court observed in footnote 18 in *LaSalle* that there existed a potential for expansion of criminal discovery rights of the Justice Department and infringement on the role of the grand jury, this Court expressed its opinion that the potential for abusive use of the summons by the IRS prior to a recommendation to the Department of Justice for criminal prosecution appeared remote and therefore did not justify an absolute ban of the use of the summons before recommendation.

Left unanswered is what this Court considers to be a good faith pursuit of a legitimate purpose by the IRS in issuing the summons.

Even assuming that the Court of Appeals is correct in holding that the IRS meets its burden of showing good faith by having the Special Agent who issued the summons in an investigation which is criminal only testify that he has requested the assignment of a revenue agent to the case to determine civil tax liability, the issue remains as to what this Court intended by its pronouncement in *LaSalle* that it will not countenance delay in submitting the case to the Department of Justice where there is an institutional commitment to refer the matter for prosecution.

Whether the IRS can so delay referral to the Department of Justice or whether the IRS may properly use the summons in good faith in an investigation that is criminal only is a matter for this Court to decide.

In *United States v. Pillsbury Credit Union*, 661 F.2d 1195 (8th Cir. 1981) the court has held that a summons issued by a special agent conducting an investigation pursuant to the Manual Supplement was authorized even where no revenue agent was assigned to the case because

the Manual Supplement represents only an institutional commitment to investigate as opposed to prosecute. Said holding appears to be at variance with the holding of this Court noted in footnote 18 of *LaSalle National Bank, supra.* Additionally, *Pillsbury Credit Union, supra,* is distinguishable from the instant case because in *Pillsbury, supra,* the taxpayers conceded on the record that the Government had made its prima facie showing of good faith. No such concession exists in the instant case.

Even so, the issue remains for this Court to determine whether an investigation that is only criminal is permissible where, if the investigation produces evidence of conduct within the scope of the Manual Supplement, then the matter will be referred to the Department of Justice for criminal prosecution without any further consideration by the IRS as to any civil tax determination.

III.

THE COURT OF APPEALS, IN CONFLICT WITH THE PRIOR DECISIONS OF THIS COURT AND FEDERAL RULES OF CIVIL PROCEDURE, RULE 52, INCORRECTLY HELD THAT IN AN IRS SUMMONS ENFORCEMENT CASE, IT MAY DISREGARD THE FINDING OF A TRIAL COURT THAT THE SOLE INSTITUTIONAL COMMITMENT OF THE IRS IS CRIMINAL PROSECUTION AND SUBSTITUTE ITS OWN FINDINGS THAT THE INVESTIGATION WAS A JOINT INVESTIGATION OF BOTH CRIMINAL AND CIVIL TAX MATTERS UPON A RECORD DEMONSTRATING THAT THE IRS HAS SUCCESSFULLY RESISTED DISCOVERY, SOUGHT ENFORCEMENT OF A SUMMONS ISSUED PURSUANT TO AN INVESTIGATION CONDUCTED

IN ACCORDANCE WITH AN OFFICIAL PROGRAM THE ONLY OBJECT OF WHICH IS CRIMINAL PROSECUTION, PRODUCED ONLY THE SPECIAL AGENT WHOSE TESTIMONY WAS CONTRADICTORY AND HAS CONSCIOUSLY FAILED TO CALL THE REVENUE AGENT WHO WAS REPRESENTED BY THE IRS TO BE PRESENT IN THE COURTROOM.

Federal Rules of Civil Procedure, Rule 52 provides:

> "Findings of fact shall not be set aside unless clearly erroneous and due respect shall be given to the opportunity of the trial court to judge the credibility of the witnesses."

In defining the scope of review of findings of fact by an appellate court this Court has held:

> "The authority of an appellate court, when reviewing the findings of a judge as well as those of a jury, is circumscribed by the deference it must give to decisions of the trier of the fact, who is usually in a superior position to appraise and weigh the evidence. The question for the appellate court under Rule 52(a) is not whether it would have made the findings the trial court did, but whether 'on the entire evidence [it] is left with the definite and firm conviction that a mistake has been committed.' "

United States v. United States Gypsum Co., 333 U.S. 364, 395, 68 S.Ct. 525, 542, 92 L.Ed. 746 (1948); *Zenith Radio Corp. v. Hagettini Research, Inc.*, 395 U.S. 100, 124, 89 S.Ct. 1562, 1576, 23 L.Ed.2d 129, 148 (1969).

Rule 52 is consistently interpreted in the 5th Circuit to mean that:

> "The question is not simply whether the reviewing court would have found otherwise, but whether the trial court could permissibly find as it did."

Movible Offshore, Inc. v. The M/V Wilken A. Falgout, 471 F.2d 268, 271 (5th Cir. 1973); *Guardian Life Insurance Company of America v. Eagle,* 484 F.2d 382 (5th Cir. 1973); *Baggett v. Richardson,* 473 F.2d 863 (5th Cir. 1973); *Bryan v. Kershaw,* 366 F.2d 497 (5th Cir. 1966).

While it is apparent from the opinion of the Court of Appeals that it found differently from the trial court, it is also apparent that the Court of Appeals has clearly used an erroneous standard of review.

There is no written evidence in the record of this case of the following findings by the Court of Appeals:

1. an audit of a partnership tax return;
2. involvement by the Examination Division in any manner though as discussed in the facts, supra, there is some evidence in the Administrative Control Form attached as an exhibit to one of the petitions that it was not;
3. referral to Ackley for investigation of possible tax fraud;
4. joint investigations with a revenue agent;
5. the presence of a revenue agent;
6. any effort by Ackley to determine any tax liability other than the statements contained in the summonses in issue.[8] Opinion pg. 816

8. Such evidence is only the printed words appearing on the summons forms. Ackley has admitted the summonses were issued pursuant to an investigation under the Manual Supplement and this Court has correctly found that the Manual Supplement relates only to a criminal investigation.

Ackley's testimony, demonstratively contradictory, is the only basis for the appellate court's evidentiary findings which set aside the findings of the trial court.

But, the trial court made clear at the conclusion of the hearing that it rejected these conclusions of the appellate court when it stated:

> "I think it is clear that the institutional posture of the Internal Revenue Service is that they are going to prosecute this case and that is what they started it for . . ."
>
> (Tr. Vol. VIII pg. 41 L. 20-24)

Contrary to the statement contained in the appellate court's opinion that the trial court denied enforcement:

> ". . . on the sole ground that the 'present posture' of the IRS was focused on its criminal investigation . . ."
>
> Opinion pg. 818

in fact, the trial court found in its Order of July 7, 1980:

> ". . . as far as the present posture of the IRS is concerned, the case is solely a criminal one."

The application of the rule requiring the appellate court to determine only whether there is a basis to support the trial court's findings seems all the more compelling where Watson has been denied any discovery and the IRS has declined to call the alleged revenue agent to the witness stand.

The rule in the Fifth Circuit is that the burden to show that the fact findings of the trial court are in error is

especially strong where the findings are based upon oral testimony as is the instant case. *Bryan v. Kershaw, supra; Horton v. United States Steel Corp.*, 286 F.2d 710 (5th Cir. 1961); *Galena Oaks Corp. v. Scofield*, 218 F.2d 217 (5th Cir. 1954). But where is such showing?

In effect, the Court of Appeals now holds that inconsistent testimony of a special agent of the IRS, unlike testimony of other witnesses, must as a matter of law be construed most favorably to support the contentions of the IRS.

It is the clear rule in the Fifth Circuit that the failure of a party to call a witness available to that party who has knowledge of the facts raises the inference that such witness would give testimony unfavorable to that party. *United Broadcasting Company v. Armes*, 506 F.2d 766 at 770 (5th Cir. 1975); *Acme Boat Rentals, Inc. v. J. Ray McDermott & Co.*, 424 F.2d 393 at 395 (5th Cir. 1970).

In the instant case, it was for the trier of fact to determine the degree of credibility to be given to each witness and to reach its conclusion based upon all admissible evidence and lawful inferences. There is no way to reconstruct for this Court the scene that existed in the trial court on June 17, 1980 where the only witness to testify was Ackley. The trial court, in perfect fairness and candor, invited the IRS to produce additional evidence and clearly ruled in part based upon the representation of the IRS that it had available in the courtroom to call as a witness the revenue agent, but elected not to call him.

From Watson's pleadings, the IRS knew Watson was contending the investigation was solely criminal pursuant to the Manual Supplement and yet they produced neither

a single writing nor the revenue agent to establish any civil investigation. And since Watson had been denied any discovery (Tr. Vol. VIII pg. 3 L. 4-9) neither the identity nor even the existence of the revenue agent could have been or was known to Watson. Consequently, the revenue agent was available only to the IRS.

Still, the trier of fact waited five and one-half (5½) months until December 9, 1980 before finally ruling in the matter in order to provide the IRS an opportunity to produce evidence of any interest by the IRS in the tax liabilities of Watson. The IRS elected not to produce any such evidence.

The rule which permits the trier of fact to draw an inference against a party as a result of the failure of that party to produce evidence readily available to it and not to the other party obviously goes far in eliminating gamesmanship from trials and is reasonably calculated to cause all relevant and material facts to be exposed to the full light of day in the trial of any matter.

To Watson, making summons enforcement a summary proceeding affords the IRS enough fair advantage. To also change the rules of evidence so that the IRS need not even make a prima facie showing of the good faith pursuit of a lawful purpose in the use of a summons under 26 U.S.C. 7602[9] by credible evidence, is to say Watson is not entitled to the hearing guaranteed to him by both Congress and the Supreme Court. 26 U.S.C. 7604, 7609; *United States v. LaSalle National Bank*, 437 U.S. 298, 98 S.Ct. 2357, 57 L.Ed.2d 221 (1978).

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9. Authorizes the use of the summons to determine tax liability.

The trier of fact was and did lawfully infer that the revenue agent assigned to the Watson case, if called to testify by the IRS, would have testified that he was not assigned to the case.

The IRS has the initial burden to make a showing of good faith use of the summons through credible evidence; a step o'er which it must leap or else fall down, and it fell down.

Accordingly, Federal Rules of Civil Procedure, Rule 52 as construed by this Court in *Zenith Radio Corp., supra*, requires that the trial court's finding that the institutional posture of the IRS in conducting the investigation is solely a criminal one is not to be set aside.

CONCLUSION

For the reasons stated above, it is respectfully prayed that a writ of certiorari be granted to review the decision of the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,

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713/783-5212

Attorney for Petitioners,
Paul V. Watson and
Sharon E. Watson

CERTIFICATE OF SERVICE

I, Jeffrey H. Hubbard, attorney for Petitioners, Paul V. Watson and Sharon E. Watson, do hereby certify that on this 2nd day of April, 1982, three copies of the foregoing Petition for Writ of Certiorari were served upon opposing counsel by depositing same in the United States mail, postage prepaid, certified, return receipt requested, addressed to John F. Murray, Acting Asst. Attorney General, Mr. Michael L. Paup, Mr. Charles E. Brookhart, and Mr. William A. Whitledge, Tax Division, Department of Justice, Washington, D.C. 20530.

JEFFREY H. HUBBARD

Appendix

ITEM I

UNITED STATES of America and Internal Revenue Service Officer, David L. Ackley,
Plaintiffs-Appellees Cross-Appellants,

v.

UNIVERSITY SAVINGS ASSOCIATION and Emily Clark, Collection Supervisor,
Defendants,

Paul V. Watson, et al.,
Intervenors-Appellants Cross-Appellees.

No. 81-2019.

United States Court of Appeals,
Fifth Circuit.

Jan. 28, 1982.

United States and Internal Revenue Service agent brought consolidated actions to enforce Internal Revenue Service summonses against six financial institutions and one accounting firm to obtain taxpayers' records. The United States District Court for the Southern District of Texas, Ross N. Sterling, J., denied enforcement of summonses and awarded attorneys' fees to taxpayers, and appeal was taken. The Court of Appeals, Gee, Circuit Judge, held that: (1) denial of enforcement of IRS summonses on sole ground that "present posture" of IRS was focused on its criminal investigation was error; (2)

IRS may use its summons authority to aid in criminal investigation, and only in rare situations where Service abandons its pursuit of civil tax liability will summons not be enforced; and (3) award of attorneys' fees to taxpayers was abuse of discretion.

Reversed and remanded.

Appeals from the United States District Court for the Southern District of Texas.

Before GEE, GARZA and JOHNSON, Circuit Judges.

GEE, Circuit Judge:

The United States of America and Internal Revenue Service Agent David L. Ackley brought a consolidated action to enforce seven Internal Revenue Service summonses against six financial institutions and one accounting firm to obtain records pertaining to Paul V. and Sharon E. Watson ("Watsons") in connection with an investigation of the tax liability of Paul V. Watson for the years 1976 through 1978. The trial court denied enforcement of the summonses and awarded attorneys' fees to the Watsons. We believe that the district court erred in refusing to enforce the summonses, and therefore, we reverse the judgment of the court and remand the case for proceedings consistent with this opinion.

During an audit of a related partnership tax return, the Examination Division of the Internal Revenue Service was unable to find any record indicating that the Watsons had filed tax returns for the years 1976-78. Accordingly, the Examination Division referred the case to the Criminal Investigation Division to investigate possible tax fraud,

and Special Agent Ackley was assigned to conduct the investigation. Ackley determined that the case should be investigated jointly with the participation of the Examination Division and then requested the assignment of a revenue agent to investigate the Watsons' civil tax liabilities. In September 1979, Ackley received documents indicating that the Watsons were tax protestors, and he began to follow the IRS procedures for investigating tax protestors, as set out in the manual supplement entitled "Examination and Investigation of Illegal Protest-Type Activities."[1] Although these procedures relate only to a criminal investigation, a revenue agent was still assigned to investigate the civil liabilities of the Watsons. Unable to obtain information from the Watsons necessary to determine their correct tax liabilities, Ackley issued the summonses here in question.

The Watsons, citing *United States v. LaSalle National Bank*, 437 U.S. 298, 98 S.Ct. 2357, 57 L.Ed.2d 221 (1978), contested the enforcement of the summonses on the ground that the summonses authorized under 26

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1. Manual Supplement 9G-93 provides in § 6.02:
Cases involving illegal tax protests have been associated with the following violations:

. . . .

b. Title 18 U.S.C.
(1) Section 2—Principles;
(2) Section 287—False, Fictitious or Fraudulent Claims;
(3) Section 371—Conspiracy to Commit Offense or Defraud the United States;
(4) Section 1001—Statement of Entries Generally; and
(5) Section 1503—Influencing or Injuring Officer, Juror or Witness Generally.
c. The Chief CID will insure that special agents are cognizant of the elements of these offenses as they apply to cases involving illegal tax protestors.

U.S.C. § 7602[2] may not be used for a solely criminal investigation. Because Special Agent Ackley, himself, was pursuing a criminal investigation only, the Watsons believed that he could not use the summonses to aid his investigation. However, this is not a proper reading of the holding in *LaSalle*. In *LaSalle* the Seventh Circuit had affirmed the district court's refusal to enforce a summons because a special agent testified that his investigation had no civil purpose and was concerned only with obtaining information with which to recommend that the taxpayer be prosecuted. The Supreme Court, however, concluded that the improper purpose of one special agent was not dispositive of the institutional commitment by the IRS to collect taxes and that enforcement of the summons should be denied only if the Service, *in an institutional sense*, had abandoned its pursuit of the taxpayer's civil liability. 437 U.S. at 319, 98 S.Ct. at 2368.

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2. 26 U.S.C. § 7602 provides:

> For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary is authorized—
>
> (1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;
>
> (2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary may deem proper, to appear before the Secretary at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and
>
> (3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

[1-3] In *Donaldson v. United States,* 400 U.S. 517, 535, 91 S.Ct. 534, 544, 27 L.Ed.2d 580 (1971), the Supreme Court noted that Congress has authorized use of the summons for criminal investigations under 26 U.S.C. § 7602 and the corresponding regulations. Congress has created a law enforcement system in which the criminal and civil elements of tax liability are inherently intertwined. *LaSalle,* 437 U.S. at 309, 98 S.Ct. at 2363. When an investigation examines the possibility of criminal misconduct, it also necessarily inquires about the appropriateness of assessing the 50 percent tax liability.[3] The legislative history of the Internal Revenue Code supports the conclusion that Congress intended to design a system with inter-related criminal and civil elements. *Id.* at 310, 98 S.Ct. at 2364. "For fraud investigation to be solely criminal in nature would require an extraordinary departure from the normally inseparable goals of examining whether the basis exists for criminal charges and for the assessment of civil liabilities." *Id.* at 314, 98 S.Ct. at 2366. Such a departure did not occur in this case. The uncontroverted evidence on this issue was the testimony of the special agent that he was conducting a joint investigation with the assistance of a revenue agent of the Examination Division to determine the taxpayers' correct tax liability and to determine

3. 26 U.S.C. § 6653(b) provides:

If any part of any underpayment (as defined in subsection (c)) of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment. In the case of income taxes and gift taxes, this amount shall be in lieu of any amount determined under subsection (a). In the case of a joint return under section 6013, this subsection shall not apply with respect to the tax of a spouse unless some part of the underpayment is due to the fraud of such spouse.

whether evidence of any tax crimes existed. The district court's denial of enforcement on the sole ground that the "present posture" of the IRS was focused on its criminal investigation is, thus, contrary to the holding of *Lasalle*. The IRS clearly may use its summons authority to aid in criminal investigations, and only in the rare situation where the Service abandons its pursuit of civil tax liability will the summons not be enforced.

[4, 5] The district court also awarded attorneys' fees to the Watsons, concluding that the IRS acted in bad faith in seeking enforcement of the summonses. In a suit brought by the United States to enforce a provision of the Internal Revenue Code, the district court may make a discretionary award of attorneys' fees to the party prevailing against the government if the taxpayer proves that the action was frivolous, unreasonable, or without foundation. 42 U.S.C. § 1988; *Jones v. United States,* 613 F.2d 1311, 1313 (5th Cir. 1980). We find that the district court abused its discretion in awarding the attorneys' fees. There is no evidence of unreasonable conduct on the part of the government, let alone bad faith. In any event, the Watsons are no longer the prevailing party and are therefore not entitled to attorneys' fees.

REVERSED AND REMANDED.

ITEM II

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

CIVIL ACTION NO. H-80-953

UNITED STATES OF AMERICA and
INTERNAL REVENUE SERVICE AGENT,
DAVID L. ACKLEY,
Petitioners,

v.

UNIVERSITY SAVINGS ASSOCIATION, ET AL,
Respondents,

PAUL V. WATSON and SHARON E. WATSON,
Intervenors.

Arthur R. Amdur, Assistant United States Attorney, Attorney for Petitioners.

Walsh, Squires, Tompkins & McCullough (F. Witcher McCullough), Houston, Texas, Attorneys for Respondents.

Jeffrey H. Hubbard & Association, Inc. (Jeffrey H. Hubbard), Houston, Texas, Attorneys for Intervenors.

December 8, 1980.

MEMORANDUM AND ORDER:

Pending before the Court is Intervenors' motion to alter or amend order and Petitioners' motion to dismiss Intervenors' counterclaim. By its Order of July 7, 1980, the Court refused to enforce Petitioners' summonses of records pertaining to Intervenors' civil tax liability because, as determined by the Court at the show cause hearing, the institutional posture of the Internal Revenue Service (IRS) was that the investigation was intended to fix Intervenors' criminal liability for violations of the Internal Revenue Code. Intervenors now ask the Court to amend its Order to permanently enjoin Petitioners from using civil discovery to obtain evidence which is to be used in a crimnial prosecution of Intervenors. In support of their motion, Intervenors claim that on July 7, 1980, the IRS filed a petition with the Court seeking to enforce a summons against a respondent not named in this action which, Intervenors allege, demonstrates that Petitioners are determined to continue to use civil discovery to obtain evidence for a criminal prosecution.

In its Order of July 7, 1980, the Court noted that the IRS might later abandon its criminal investigation and seek to establish Intervenors' civil tax liability. However, Petitioners do not argue that their institutional posture is now aimed at determining civil tax liability, but claim rather that since they commenced the investigation they have been trying to determine both civil and criminal liability. This claim did not prevail at the show cause hearing, and for purposes of Intervenors' present motion the Court will assume that the institutional posture of the IRS remains as it was.

Congress has given the IRS, through the Secretary of the Treasury, broad powers to conduct investigations for determining the tax liability of taxpayers, including power to summon third parties who may have records relevant to the tax liability of the taxpayer. I.R.C. § 7602. However, Congress has not authorized the IRS to use its summons authority to aid in criminal investigations. *United States v. LaSalle National Bank*, 437 U.S. 298, 317 n. 18 (1978). A taxpayer who believes that an IRS summons to a third party seeks to discover information to aid in a criminal investigation has a statutory remedy. The taxpayer may restrain the third party's compliance with the summons and thus compel the IRS to seek judicial review and enforcement of the summons. I.R.C. §§ 7609(b) and 7402(b). A district court will, as the Court has done here, refuse to enforce the summons if the court finds that the IRS has exceeded its investigatory authority.

Even if the IRS successfully acquired information for a criminal investigation by way of civil discovery, a taxpayer would have yet another remedy. The taxpayer could petition the court exercising criminal jurisdiction to suppress the illegally acquired information. *United States v. Genser*, 582 F.2d 292, 308 (3rd Cir. 1978).

In their motion to dismiss, Petitioners challenge the jurisdiction of the Court regarding Intervenors' claim for a permanent injunction. The Court finds that it has jurisdiciton of this claim since it involves a substantial controversy arising under acts of Congress concerning the internal revenue. 28 U.S.C. § 1340. The Court also finds that because Intervenors have an adequate legal remedy their claim for a permanent injunction must be

dismissed. However, assuming that the institutional posture of the IRS continues to be one of seeking criminal proceedings, the Court believes that future requests for information about the tax liability of Intervenors should properly be made by a grand jury. The Supreme Court has stated that delay by the IRS for the purpose of using civil discovery to gather additional evidence for a criminal case will not be tolerated. *LaSalle National Bank, supra,* at 316-17.

Intervenors also ask the Court to amend its Order to allow costs and attorney's fees. The Court is of the opinion that Intervenors may recover their costs. Rule 54(d), Fed. R. Civ. P. The Court has discretion to award a reasonable attorney's fee to the prevailing party in an action to enforce a provision of the Internal Revenue Code. 42 U.S.C. § 1988. Thus, the Court has no discretion to award attorney's fees relating to Intervenors' counterclaim for a permanent injunction. The courts which have considered the scope of discretion under the provisions of 42 U.S.C. § 1988 have concluded that an award of attorney's fees to a prevailing taxpayer is authorized when the action was instituted in bad faith or was frivolous, harassing or vexatious. *See Bryant v. United States,* 456 F.Supp. 174, 175 (E.D. Pa. 1978), and cases cited therein. The Court is not required to find a subjective bad faith by the IRS to award attorney's fees to the taxpayer. *Id.* at 176. The IRS served these summonses and sought to enforce them when its institutional posture was that of seeking criminal proceedings. The Court concludes that the IRS acted in bad faith and that an award of attorney's fees for Intervenors' defense against enforcement of the summonses is proper. The affidavit of Intervenors' attorney asks for an attorney's

fee of $35,000. The Court will make the award in accordance with the guidelines set forth in *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714, 717-19 (5th Cir. 1974).

(1) The affidavit alleges that 101.75 hours were spent in preparation for and attendance at the show cause hearing, including 19.5 hours in conferences and 69.5 hours in research, review and briefing. Some part of this time was spent working on Intervenors' counterclaim, for which the Court will not make an award.

(2) Setting aside the questions raised by Intervenors' counterclaim, this action raised no novel or difficult questions of law. The only real issue, the institutional posture of the IRS, was a question of fact.

(3) The Court recognizes that the attorney for Intervenors was formerly employed as an attorney for the IRS, and this experience may give him substantial knowledge of IRS procedures and practices. However, the Court finds that an attorney of average skill and ability could have properly researched the legal issues involved here and clearly presented the case to the Court.

(4) Other employment would have been precluded to some extent, although the Court again will not consider time spent on the counterclaim. The Court notes that Intervenors' post-hearing instruments consist of twenty pages written by the attorney for Intervenors, most of which concern the counterclaim.

(5) The affidavit of Intervenors' attorney asks the Court to consider the fees customarily charged in Harris County for undertaking the representation of persons accused of criminal violations of the Internal Revenue

Code. The Court believes that the customary fee for representing a taxpayer who intervenes in an IRS summons enforcement action is considerably lower than the customary fee proposed by the attorney for Intervenors.

(6) The affidavit indicates that the fee arrangement is not contingent. It does not disclose the amount which Intervenors have agreed to pay.

(7) The affidavit does not allege that this matter received special priority.

(8) The affidavit alleges the financially incalculable value of the issues involved.

(9) It appears that the attorney for Intervenors is an attorney of more than average skill and ability, being board certified in civil trial law and having tried cases before numerous federal courts.

(10) The affidavit notes the undesirability of opposing an IRS investigation and undertaking the representation of an alleged illegal tax protestor. Such actions might make the attorney for Intervenors unpopular with the IRS, but certainly not with potential clients. There is no reason to believe that the pursuing of this case has had an adverse economic impact on the attorney for Intervenors.

(11) The affidavit reveals that this is the first and only employment of counsel by Intervenors. However, it is clear on the entire record that he will have more.

(12) The affidavit does not allege the amount of awards in similar cases. The attorney for Intervenors has alleged that an award of $35,000 for about 100 hours work, or $350 per hour, is customary for representing taxpayers accused of criminal violations.

In light of the foregoing, the Court finds Intervenors' claim for an attorney's fee of $35,000 to be excessive. It appears to the Court that almost all of the 69.5 hours spent on research, review and briefing were focused on the issues raised in the counterclaim for an injunction. The Court will not award attorney's fees on those matters.

The Court finds it difficult to imagine how the attorney for Intervenors could have spent more than 20 hours on preparing and arguing his defense to the enforcement of the IRS summonses. The matter was not novel or difficult. The attorney for Intervenors was clearly very well qualified to handle it. In a case such as this where the services of the attorney were undoubtedly of great value to Intervenor it would be improper to set a fee based upon an hourly rate and ignore the value of the professional service rendered. Had the injunction sought been obtained, $35,000 might be reasonable. However, the Court finds that a reasonable fee in this case is $5,000.00.

It is, therefore,

ORDERED that Intervenors' motion to alter or amend order is DENIED in part in that the counterclaim for a permanent injunction is DISMISSED. It is further ORDERED that Intervenors' motion to alter or amend is GRANTED in part in that Intervenors may recover their costs and a reasonable attorney's fee in the amount of Five Thousand and No/100 Dollars ($5,000.00).

DONE at Houston, Texas, this 8th day of December, 1980.

/s/ ROSS N. STERLING
United States District Judge

ITEM III

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON TEXAS

CIVIL ACTION NO. H-80-953

UNITED STATES OF AMERICA and
IRS OFFICER DAVID L. ACKLEY

v.

UNIVERSITY SAVINGS ASSOCIATION, ET AL

ORDER

A show cause hearing was held on June 17, 1980, to determine whether Internal Revenue Service summonses served upon the respondents in H-80-953, 954, 955, 956, 957, 958, and 959 should be enforced. Paul V. and Sharon E. Watson were allowed to intervene. Intervenors objected that the I.R.S. was not pursuing, in good faith, an investigation of their civil tax liabilities for the years in question. The evidence produced at the hearing regarding the posture of the I.R.S., as evidenced by Intervenors' Exhibit 1, the Manual Supplement concerning the criminal investigation of illegal tax protestors, especially § 6.02, in conjunction with the actions of the special agent in the criminal investigation of this case, convinces this Court that as far as the present posture of the I.R.S. is concerned, the case is solely a criminal one. While it is possible that the I.R.S. may later abandon this criminal posture and seek civil tax liabilities, that fact does not change

the present posture of this case, as set out in the Manual Supplement. It is, therefore,

ORDERED that the United States' petitions to enforce the I.R.S. summonses involving these Intervenors are herby DENIED.

DONE at Houston, Texas, this 7th day of July, 1980.

/s/ ROSS N. STERLING
United States District Judge

ITEM IV

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

CIVIL ACTION NO. H-80-953

UNITED STATES OF AMERICA and
INTERNAL REVENUE SERVICE AGENT,
DAVID L. ACKLEY,
Petitioners,

v.

UNIVERSITY SAVINGS ASSOCIATION, ET AL,
Respondents,

PAUL V. WATSON and SHARON E. WATSON,
Intervenors.

FINAL JUDGMENT

Pursuant to the Court's Order, it is

ORDERED and ADJUDGED that the petitions to enforce Internal Revenue Service summonses are dismissed on the merits. Intervenors may recover of Petitioners their costs of this action and attorney's fees in the amount of Five Thousand and No/100 Dollars ($5,000.00).

DONE at Houston, Texas, this 13th day of January, 1981.

/s/ ROSS N. STERLING
United States District Judge

ITEM V

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

NO. 81-2019

UNITED STATES OF AMERICA and
INTERNAL REVENUE SERVICE OFFICER,
DAVID L. ACKLEY,
Plaintiffs-Appellees Cross-Appellants,

v.

UNIVERSITY SAVINGS ASSOCIATION and
EMILY CLARK, Collection Supervisor,
Defendants,

PAUL V. WATSON, ET AL.,
Intervenors-Appellants Cross-Appellees.

Appeal from the United States District Court for the
Southern District of Texas

ON PETITION FOR REHEARING AND
SUGGESTION FOR REHEARING EN BANC

(Opinion January 28, 1982, 5 Cir., 198__, __F.2d__).

(March 10, 1982)

Before GEE, GARZA and SAM D. JOHNSON, Circuit Judges.

PER CURIAM:

(√) The Petition for Rehearing is DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Rule 35 Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 16) the Suggestion for Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

/s/ THOMAS GIBBS GEE

ITEM VI

MANUAL SUPPLEMENT

Department of the Treasury

Internal Revenue Service

January 10, 1979

9G-93	47G-124
41G-128	48G-289
42G-390	5G-220
44G-83	7(10)G-36
45G-314	81G-38
46G-24	

Examination and Investigation of Illegal Tax Protest-type Activities

Section 1. Purpose

.01 This Supplement provides uniform procedures and guidelines for detecting, processing, examining and investigating illegal tax protest-type documents and activities. It is intended to provide a broad framework that can be adapted by field personnel to assure compliance with the tax laws on the part of illegal tax protesters.

.02 The procedures in this Supplement are not directed towards suppressing dissent or prosecuting individuals because they are critical of, or are identified with groups critical of, the tax system or government policies. The purpose of these procedures is to further the total Service objectives of encouraging and achieving the highest degree of voluntary compliance with the tax laws by enforcing statutory sanctions.

.03 This Supplement incorporates the substance of Manual Supplement 9RDD-3, CR41RDD-19, 42RDD-55, 45RDD-8, 5RDD-8, 7(10)RDD-1, 81RDD-3, Illegal Tax Protester Project, dated November 21, 1978.

Section 2. Background

.01 Some so-called tax protesters are making speeches and offering seminars around the country at which serious misrepresentations about the tax laws are being presented to the public as fact.

.02 Generally these protesters are counseling taxpayers not to comply with the Federal income tax return filing statutes on the ground that they violate a person's constitutional rights under the Fifth Amendment. As early as 1927, the Supreme Court of the United States held in *United States v. Sullivan,* 27 U.S. 259 (1927), that a taxpayer could not refuse to file a Federal income tax return because of the Fifth Amendment privilege against self-incrimination.

.03 Further, the requirement that a taxpayer include information on the tax return concerning income does not by itself, violate the self-incrimination clause of the Fifth Amendment as the court noted in *United States v. Daly,* 481 F.2d 28 (8th Cir. 1973), *cert. denied,* 414 U.S. 1064 (1973). This case, as well as others, represents an extension of the holding in *Sullivan* that a taxpayer must do more than file a blank tax return or tax return with little or no information.

.04 Illegal protesters also assert that various provisions of the Internal Revenue laws violate the due process clause of the Fifth Amendment. Generally they claim

that the graduated income tax scale and the fact that certain deductions or benefits allowed by the Internal Revenue Code are available to some and not to others deny those latter persons their Constitutional rights. The protesters also assert that some of the statutory collection procedures violate the due process clause. However, in *Swallow v. United States,* 325 F.2d 97 (10th Cir. 1963), *cert. denied,* 377 U.S. 951 (1964), the court held, "It is now well settled that the income tax laws are not unconstitutional under the due process clause of the Fifth Amendment. . . ."

.05 Federal Courts have held in numerous cases that there is no Constitutional right to refuse to pay income taxes in whole or part on religious or moral grounds or because the funds are used for government programs that the taxpayer opposes. For example, in *Autenrieth v. Cullen,* 418 F.2d 586 (9th Cir. 1969), *cert. denied,* 397 U.S. 1036 (1970), the court said, "The fact that some persons may object, on religious grounds, to some of the things that the government does is not a basis upon which they can claim a constitutional right not to pay a part of the tax."

.06 Some illegal protesters have offered an argument that income in the form of currency or checks is not subject to tax on the grounds that currency is now worthless since the United States is no longer on a gold or silver standard. They also argue that Federal Reserve notes are only accounts receivable and thus are not subject to tax. However, the law taxes "income from whatever source derived" and income may be in many forms, including currency, goods and services. In *United States v. Daly,* 481 F.2d 28 (9th Cir.) *cert. denied,* 414 U.S.

1064 (1973), the court, referring to the gold and silver argument, stated, "This contention is clearly frivolous." The court arrived at a similar conclusion in *United States v. Wangrud*, 533 F.2d 495 (9th Cir. 1976). Recently the Tax Court in *Hatfield v. Commissioner*, 68 T.C. _____, No. 78 (Sept. 12, 1977), which involved a Fifth Amendment return, dismissed an argument that Federal Reserve notes should not be taxed since they constitute accounts receivable.

.07 Some illegal protesters have promoted noncompliance through tax schemes involving family estate trusts, while others have offered assignments of all income to newly created organizations purporting to be churches, religious orders, or other religious organizations in which the organization acts only as a nominee receiving the assigned income which is then used to pay the donor's living expenses.

.08 Under the family estate plan the individual is advised to assign assets and income from current employment to the trust. The promoters then advise that, in exchange, the creator of the trust may receive "compensation" as an officer, trustee or director, as well as certain "fringe benefits," such as "pension rights," "tax-free use of a residence," and "educational endowments" for children.

1 According to the promoters, once the creator's income is shifted to the trust, the trust is supposedly taxed only on undistributed new income. The promoters misrepresent that substantially all living expenses of the grantor and his or her family may be deducted on the trust's fiduciary income tax return as business expenses

and that the balance might then be distributed to the creator's family or to a separate "non-profit" educational trust leaving little or no taxable income to be reported.

2 Several IRS rulings have been published adverse to these schemes, and IRS challenges to these trusts have been upheld in various court cases.

3 One of the most basic principles of taxation is that income is taxed to the taxpayer earning it. In other words, a person cannot escape the liability to report and pay tax on income of such person that is assigned to another person or entity. Thus, the United States Tax Court has recently rejected taxpayers' arguments that assigning to family trusts all compensation for services of the creator relieved the creator of reporting and paying tax on such compensation.

.09 While the "church" or "religious order" plans vary in certain aspects, a common scheme calls for an individual taxpayer to obtain minister's credentials and a church or religious order charter by mail for a fee. No profession of adherence to a creed, dogma, or moral code may or may not be required and duties of fiduciary responsibilities may or may not be undertaken in order to receive and administer these charters or credentials. The individual sets up an organization that purports to be a church, religious order, or other religious organization. The plan then calls for the individual to take a "vow of poverty" and to assign the individual's assets—house, car, savings account, etc.—and the income earned from current employment to the new organization. The income assigned is expended for housing, food, clothing, personal transportation and other living expenses incurred by the individual, and for his or her occasional "spiritual re-

treats" to traditional vacation areas. Typically, the solicitations conclude that a vow of poverty can make a person rich.

1 Such representations are misleading and plans of the type described will not produce the tax benefits claimed by their promoters. The tax law affords significant benefits to churches and other religious organizations and to individuals who make gifts or contributions to qualified organizations. The law requires, however, that religious organizations qualifying for certain tax benefits actually be operated for religious purposes and that they not be operated for private purposes.

2 Under a recently published IRS ruling and established principles of tax law, such an assignment of income whether by an individual claiming to be under a vow of poverty, or otherwise, will not prevent the individual from being taxed on such income. Moreover, when the organization to which income is assigned is not actually organized and operated for religious purposes, the assigned income will not be deductible by the taxpayer. In any event, contributions to an organization are not deductible when made in the expectation of receiving some commensurate benefit in return.

Section 3. Program Responsibility

.01 The Assistant Commissioner (Compliance) is designated as the senior coordinating official responsible for implementing this program and for monitoring its progress. The Director, Criminal Investigation Division; the Director, Examination Division; the Director, Collection Division; and the Director, Appeals Division will share responsibility for coordinating and monitoring the

project on behalf of the Assistant Commissioner (Compliance). Each of these directors shall designate a National Office Project Coordinator from his/her respective function.

.02 The Assistant Commissioner (TX), Assistant Commissioner (E), Assistant Commissioner (PR) will designate a functional coordinator in the Returns Processing and Accounting Division, Exempt Organizations Division, Research and Operations Analysis Division, and any other division they deem appropriate.

.03 Regional Commissioners will designate an Illegal Tax Protestor Coordinator who will closely monitor all aspects of the project to ensure that the project objectives are achieved.

.04 District Directors, Director of International Operations, and Service Center Directors will designate an Illegal Tax Protestor Coordinator responsible for monitoring the implementation of the project.

Section 4. Scope

.01 For purposes of this program, an illegal tax protestor is a person who employs one or more illegal schemes that affect the payment of taxes. The illegal tax protestor scheme definitions that will be used to identify individuals to be included in this program appear on Attachment 1.

.02 This program will include all cases which were identified as potential illegal tax protesters starting January 1, 1978. The scheme definitions will be applied to cases currently in progress and in the pipeline and these will also be included in the program. Cases that do not fall within the parameters established by this Supplement will not be included in the program.

Section 5. Service Center Procedures

.01 The initial detection of illegal tax protester-type documents will be made in the Returns Processing and Accounting area of the service center. Specific instructions can be found in IRM 3(11)30.

.02 *Service Center Team*

1 Each service center will establish a team to act as a control point for counting and analyzing illegal tax protest returns and/or other documents. This team should be under the direction and control of the Compliance Division.

2 All returns and/or other documents identified as involving potential illegal tax protester schemes will be forwarded to the service center team for initial screening prior to processing.

3 The service center team will be responsible for determining which returns/documents fall within the parameters of illegal tax protestor activities. These determinations will be based upon the scheme definitions (Attachment 1) and experience factors of the team members. Each return/document will be referred to the team with Form 4227, Intra SC Reject or Routing Slip. The acceptance or rejection of the referred item is to be notated on this form. Additionally, other processing instructions are to be notated on this form, e.g., "Unallowable Code 81 to be entered." Any returns/documents that do not fall within the purview of this program will be processed in accordance with established guidelines.

4 The service center team will count and classify each return/document. This information will be compiled and reported on the Illegal Tax Protester Count

Summary Form, Form 6179. This is a monthly form and will be forwarded through the Regional Coordinator to the Director, Criminal Investigation Division (Attn. CP:CI:O) on the last workday of each month beginning with January, 1979. The service center team will ensure that only individuals accurately determined to be illegal tax protesters will be counted. For purposes of this program, a joint return that is not signed by the spouse will be considered as one return and one taxpayer. If the spouse signs the return, it will be considered as one return and two taxpayers.

5 The service center team will prepare an alpha card or other appropriate record for each identified illegal tax protester. This will serve as the control document for recording the flow of the return/document through the processing and work cycles. It will also serve as the control document for future operational and program needs. The alpha card should include the name, street address, and city, state and zip code, social security number or employer identification number, type of illegal scheme, type of tax form(s) and years, date return or document was received in the service center, action taken and date of action, and any comments.

6 The service center team will attach a copy of Forms 6178, 6178A, 6178B, 6178C, and 6178D, Illegal Tax Protester Functional Report to the return/document. To avoid any delay in processing, these forms should be attached to the back of the return/document. These forms will remain with the return/document until final disposition is made by the Service. At the time of final disposition, these forms will be detached and returned to the service center team.

7 The Illegal Tax Protester Functional Reports will provide relevant data concerning actions taken by each function while in possession of the case.

a. In order to develop pertinent data relevant to the flow of work generated by illegal tax protesters, the service center team will be notified when the return/document is forwarded between functions at the service center and functions at the district offices.

b. Upon final disposition of a return/document by the Service, the Illegal Tax Protester Functional Reports will be forwarded to the service center team. Beginning with the quarter ended March 31, 1979, the service center team will forward copies of the completed Illegal Tax Protester Functional Reports to the Director, Criminal Investigation Division (Attn: CP:CI:O) within two weeks after the close of the quarter. District Illegal Tax Protester Coordinators will ensure that copies of completed Illegal Tax Protester Functional Reports are forwarded to the service center team as soon as the case is disposed of at the district level by all functions.

8 A copy of questionable Forms 4361, Application for Exemption from Self-Employment Tax for Use by Ministers, Members of Religious Orders, and Christian Science Practitioners, and Forms 4029, Application for Exemption from Tax on Self-Employment Income and Waiver of Benefits and/or any other document used in lieu of these forms, filed with the service center will be referred to the service center team for screening. The service center team will determine if the individuals identified on the questionable forms fall within the parrameters of this program. If the individuals are to be included in the program, an attempt will be made to obtain the current and prior years returns.

a. If it is determined that the current and prior year returns have been filed, the service center team will follow the procedures outlined in Sections 5.027 for processing returns/documents.

b. If it is determined that the required returns have not been filed, the team will attach the Illegal Tax Protester Functional Report to the Form 4361, 4029, or other document. The team should prepare Form 3949, Information Item, and process the information in accordance with IRM 9311. The team should also notify the appropriate function at the service center concerning the disposition of the information regarding the individual identified on the questionable Form 4361, 4029, and/or other document.

c. The service center team will include the number of suspected Forms 4361, 4029, and or other documents on Form 6179. Additionally, the team will maintain a record of the total number of Forms 6179 that were screened by the team.

.03 The following procedures are concerned with the processing of returns/documents after the service center team has had an opportunity for initial processing and screening. All returns/documents will be forwarded to the Chief, Criminal Investigation Branch (CIB) for appropriate action.

1 *Non-Processable Documents*

a. A letter 664 (SC) notice to taxpayer that his/her Form 1040 is not acceptable, will be mailed to the taxpayer, via registered mail, return receipt requested. The original protest document and a copy of Letter 664

(SC) to the taxpayer will be retained by the Chief, CIB in a suspense file for thirty days.

b. Returns for the three prior years will be requisitioned and associated with the current protest return.

c. Any integrated Data Retrieval System (IDRS) information showing closed or open Collection activity will also be associated with the return.

d. The taxpayer's name will be searched through the Information Item Indexes. (See IRM 9390).

e. If a valid return is received, the Chief, CIB will attach it to the front of the protest return and forward it to the Receipt and Control Branch for regular processing.

f. If there is no reply or if another protest return or document is received within the 30-day suspense period the Chief, CIB will prepare Form 3949 (Information Item) and enter it into the Centralized Evaluation and Processing of Information Item System (CEPIIS) at the service center. The item will be selected by the Chief, CIB for the Criminal Investigation Division and forwarded along with appropriate prior year returns, the copy of Letter 664 (SC) and any other associated material, to the Chief, Criminal Investigation Division of the district in which the taxpayer resides.

g. After evaluation, those cases lacking criminal prosecution potential will be routed to the service center Collection function.

2 *Processable Returns*

a. Protest returns which reflect income and/or claim clearly unallowable deductions or credits for protest

reasons, or which identify the omission of a portion of the income or tax for protest reasons, i.e., Fair Market Value, Non-payment Protest, etc., will be reviewed by the Chief, CIB to determine whether they have evidentiary value in connection with pending or anticipated criminal cases.

(1) If such review indicates that they have evidentiary value, they will be associated with the appropriate criminal case.

(2) If they have no evidentiary value, or when they have served their evidentiary purposes, they will be routed by the Chief, CIB through CEPIIS to Code and Edit to assure that unallowable Code 81 is input on processing in accordance with IRM 3(11)34.(11).

b. Protest amended returns and protest claims will be reviewed by the Chief, CIB to determine if they have criminal potential.

(1) The cases with criminal potential will be selected by the Chief, CIB for appropriate action.

(2) The cases lacking criminal potential will be routed by the Chief, CIB to the service center Adjustment Branch for preparation and mailing of "no-consideration" letters.

c. Vow of Poverty returns received by the Chief, CIB will be reviewed for Criminal potential.

(1) Those cases with criminal potential will be selected by the Chief, CIB for appropriate action.

(2) Those cases that lack criminal potential will be given an unallowable item code of 83. The unique unallowable code will freeze the refund.

(3) The service center Classification Branch will screen all of these returns to determine if the vow of poverty issue should be examined. Returns selected for examination of this issue will be transferred to the appropriate district RPM. The cases selected must be "flagged" to alert the district that there is a frozen refund. The service center Examination Division will not attempt to resolve a vow of poverty issue by correspondence.

(4) If the vow of poverty ceases to be an issue, the refund will be released pending resolution of other issues.

(5) Cases where the vow of poverty issue occurs on claims for refund will be coded as Claims Criteria A. These claims will be referred to the district for examination.

d. Family Estate Trust returns will be reviewed by the Chief, CIB for criminal potential.

(1) Those cases with criminal potential will be selected by the Chief, CIB for appropriate action.

(2) Those cases that meet the criteria of an illegal tax protester but lack criminal potential, will be referred to the service center Classification Branch.

e. Returns identified as "Protest Adjustment" will be reviewed by the Chief, CIB who will have the refund stopped. The Chief, CIB will prepare Form 3949 and process this in accordance with CEPIIS guidelines and forward the case to the appropriate district function for processing. The district Criminal Investigation Division or Examination Division would be responsible for releasing the refund.

f. Protest letters and cards will be forwarded to the Chief, CIB for review who will determine the appropriate action to be taken.

g. Guidelines for the detection and processing of improper Forms W-4 are found in Manual Supplement 42G-382, Establishment of Uniform Procedures to Detect and Correct Improper Use of Form W-4, dated July 31, 1978.

(1) If an improperly prepared Form W-4 pertains to a year in which a tax return is not yet due, a follow-up file will be maintained by the Chief, CIB to insure that the current-year return is researched at the appropriate time. Therefore, Form 3949 or other appropriate information will be forwarded to the Chief, CIB, at the service center.

(2) The Chief, CIB will be responsible for determining if returns are filed and appropriate processing of the information obtained.

(3) The names of taxpayers not serviced by the service center receiving the initial information, will be forwarded to the appropriate service center Chief, CIB for processing in accordance with IRM 9311.3(2).

.04 Any service center function identifying a numbered return which appears to be an illegal tax protest return that has not received the proper coding will discuss the return with the Chief, CIB for advice on proper treatment.

Section 6. District Office Procedures

.01 All indications of illegal tax protester activities initially detected in the district will be referred to the

district Illegal Tax Protester Coordinator. The district coordinator will be responsible for evaluating the information received and determining if the guidelines contained in this Supplement are pertinent. If these guidelines are applicable, the coordinator will forward the information to the service center team for counting and any additional processing that may be required.

.02 *Criminal Investigation Division Procedures*

1 Each protest return received from the Chief, CIB will be immediately assigned for evaluation in accordance with IRM 9331.2 and Manual Supplement 9G-82, Centralized Evaluation and Processing of Information Items, dated June 29, 1978. This evaluation will be completed within 15 working days from the date of receipt. To assist in evaluation of the criminal potential of protest cases, the Chief, CID may assign the item to a special agent for limited inquiries, as defined in IRM 9311.2(3). Also, if necessary for proper evaluation, the Chief may authorize individual information gathering as provided for in Manual Supplement 9G-92. When unusual legal questions exist, the Chief is encouraged to contact District Counsel for advice.

2 If the case is selected for investigation, the district will submit a Form 4135 (Criminal Investigation Control Notice) to the service center to establish a TC 914 Control.

3 Cases selected for investigation will be designated as priority cases and investigated as expeditiously as possible. To ensure that illegal tax protester cases are investigated as quickly as possible, the Chief, Criminal Investigation Division should consider devoting additional

resources to these cases and/or establishing names of special agents to work these cases.

4 In selecting cases for investigation, consideration should be given to the potential impact and/or deterrent effect a successful prosecution case will generate. Experience in this area has indicated that cases involving leaders and/or flagrant non-compliance situations achieve the best results. (See Policy Statement P-9-3).

5 Any surveillance activities conducted in conjunction with illegal tax protester cases and/or information gathering projects will conform to the guidelines contained in IRM 9383.6.

6 Any district information gathering projects must be authorized in accordance with Manual Supplement 9G-92.

7 Guidelines and procedures regarding the use of informants are found at IRM 9373.

8 Guidelines concerning the use of confidential expenditures are found at IRM 9372.

9 Since some so-called tax protesters advocate the use of force in dealing with Service personnel, the special agent assigned the investigation should consider having all contracts with the taxpayer made at the district office or the post of duty nearest the taxpayer. If it is determined that this could jeopardize successful completion of the investigation, the special agent's group manager will be consulted prior to contact with the taxpayer. Also, special agents should recognize that many third-parties may also be illegal tax protest advocates. Extreme care and discretion should be exercised prior to making contacts that could fall into this category.

10 Cases involving illegal tax protesters have been associated with the following violations:

a. Title 26 U.S.C.

(1) Section 7201—Attempt to Evade or Defeat Tax;

(2) Section 7203—Willful Failure to File Return, Supply Information or Pay Tax;

(3) Section 7202—Willful Failure to Collect or Pay over Tax;

(4) Section 7205—Fraudulent Withholding Exemption Certificate or Failure to Supply Information;

(5) Section 7206—Fraud and False Statements; and

(6) Section 7212—Attempts to Interfere with Administration of Internal Revenue Laws.

b. Title 18 U.S.C.

(1) Section 2—Principals;

(2) Section 287—False, Fictitious or Fraudulent Claims;

(3) Section 371—Conspiracy to Commit Offense or to Defraud United States;

(4) Section 1001—Statement or Entries Generally; and

(5) Section 1503—Influencing or Injuring Officer, Juror or Witness Generally.

c. The Chief, CID will ensure that special agents are cognizant of the elements of these offenses as they apply to cases involving illegal tax protesters.

d. If unusual legal problems surface during investigations of illegal tax protesters, pre-referral assistance from District Counsel should be requested.

11 Resources should be devoted towards only the most flagrant cases involving the use of a "Vow of Poverty" and/or "Mail Order Ministries" to evade taxes.

12 When a prosecution case is submitted to District Counsel, the transmittal memorandum should designate it as an illegal tax protester case and request that District Counsel provide an expeditious review. Reports recommending prosecution under Section 7205 regarding Form W-4, Employee's Withholding Allowance Certificate, will be processed in accordance with IRM 9625.1:(2)(a).

13 After evaluation, those cases lacking criminal potential will be processed as follows:

a. Cases involving illegal tax protest schemes of Constitutional Basis, Gold/Silver Standard, and Blank Form 1040/1040A, will be forwarded to the Chief, Collection Division (Attn: Illegal Tax Protester Coordinator) with copies of all available information.

b. Cases involving all other illegal tax protest schemes will be forwarded to the Chief, Examination Division with copies of all available information.

c. As a minimum, the information sent to Collection or Examination will include the following:

(1) copy of original protest document;

(2) copy of Letter 664 (SC) sent to taxpayers;

(3) copy of reply to Letter 664 (SC), if any;

(4) copies of tax return or documents for prior (3) three years;

(5) IDRS history of Collection activity, and

(6) Results of evaluation. This should include all information obtained during the evaluation.

14 The original protest document will be sent to the Chief, CIB for filing with a notation reflecting disposition of the case.

15 Discontinued and non-prosecution cases will be processed in accordance with IRM 9327.2, 9520, 9632, and 9633.

16 Case Management and Time Reporting Systems

2 National Office Project Number 30 has been designated to track Criminal Investigation Division activity under the Case Management and Time Reporting System (Report Symbol NO-CP:Cl-46). Accordingly, each region and district will establish a project number, using National Office Project Number 30 as the first two digits (see 330 of IRM 9570, Case Management and Time Reporting System Handbook). The designated project number will be entered in Item 31 of Form 4930 (Criminal Investigation Case/Project Report) for each case and each information gathering project which qualifies for inclusion in this program.

b. Illegal Activity Code 166 will be entered in Item 11 of all Forms 4930 for cases accepted by the Criminal Investigation Division for investigation.

c. The district will revise all Forms 4930 regarding open and/or closed projects and/or cases and enter the information in 1 and 2 above.

17 The Chief, CID will forward, through the District Director, to the Assistant Regional Commissioner

(Criminal Investigation), on a quarterly basis, the following information concerning illegal tax protester activities in the district. (Report Symbol NO-CP:Cl-62 controls this report.)

a. Number of Illegal Tax Protester

(1) Cases Under Investigation

(a) Beginning of Quarter

(b) Started during Quarter

(c) Closed during Quarter

(d) End of Quarter

b. Legal Actions During Quarter

(1) Total Number of Convictions

(a) Violations Involved in Convictions

(b) Sentences: Prison; Suspension; Probation; Fines

(c) Taxes and Penalties Recommended

(d) Schemes Used

(2) Indictments

(3) Informations

(4) Trials

(5) Pleas

(6) Percent Receiving Prison Sentences

(7) Cases Appealed and Disposition

(8) Other pertinent information regarding illegal tax protester activity, i.e., new schemes, new tech-

niques, problems encountered in investigations with counsel and/or U.S. Attorneys, etc.

c. Special Agent Time—hours.

(1) The report should be forwarded within 10 work days from the end of the calendar quarter, beginning with the quarter ended March 31, 1979.

(2) District reports will be compiled at the regional level and submitted to the Director, Criminal Investigation Division (Attn: CP:Cl:0) within 20 work days from the end of the calendar quarter beginning with the quarter ending March 31, 1979. (Report Symbol NO-CP:Cl-62 controls this report.)

.03 *Examination Division Procedures*

1 Tax protesters returns will be considered priority cases, by the Examination Division, as described in 632:(4) of IRM 4(10)20, Handbook for Audit Group Managers.

2 Those returns will be expeditiously assigned to an examiner and the examination will be initiated within 30 calendar days from the date of receipt in the district Examination Division.

3 Group managers should consider the potential hazards to personal safety of Revenue Agents examining these returns. Meetings between the examiner and the protester taxpayer should be held, where practical, in a government facility. The group manager may make other arrangements to facilitate the examination when it would not compromise the safety of the examiner.

4 These examinations must be completed as expeditiously as possible. Each district will submit to the region

a Quarterly Examination Activity Report NO-CP:E:438 within 10 work days from the end of the calendar quarter which will be compiled and submitted to the National Office (CP:E:S:S) within 20 work days from the end of the calendar quarter beginning with the quarter ending March 31, 1979. The following information will be included in the report to the region for each category of protester scheme.

a. Protester Returns Under Examination Beginning of Quarter

b. Protester Returns Examination Standard During Quarter

c. Protester Returns Examination Closed During Quarter

d. Protester Returns Under Examination At the End of Quarter

e. Protester Returns Surveyed During Quarter

5 In addition to the statistics, a listing of all protester returns which were started in prior quarters and are still open at the end of this quarter will be submitted to the region for their use in monitoring the program. This list should contain, as a minimum, taxpayer name, year under examination, date started, type of form, and reason for delay.

6 For Technical Time Reports, Forms 4502 and 4502-A, Feature Code 6 has been assigned to Illegal Tax Protester cases. A Feature Code is the sixth digit of the Activity Code for Direct Examniation Time (for example, 106306. In order to track the time, Table Z-26, Tax Protester Cases—Applied Time Analysis, will be pro-

duced quarterly at the Data Center. The usage of this Feature Code will be incorporated in (13)00 of IRM 4810, Audit Reports Handbook.

7 Several of the protest schemes result in documents filed with the Service which are not considered as returns. These cases will be considered as nonfilers and will be assigned in accordance with procedures in IRM 411(10) concerning Form 3449, Collection Referrals of Nonfilers. Some of the "Schemes," which result in a nonfiler case, include "Constitutional Basis" (Porth/Daly, 5th Amendment, 4th Amendment, 16th Amendment), "Gold/Silver Standard," "Blank Form 1040." These cases will be worked by the Criminal Investigation and Collection Divisions in accordance with this Supplement before assignment to the Examination Division. The case file will contain all documents and workpapers developed by the other divisions and meet the criteria of proper development by the Collection Division.

8 The examiner should initially contact the protester taxpayer and make a good faith effort to complete a normal examination. If the protester taxpayer is completely uncooperative, this fact should be appropriately documented in a memorandum for the file. This will include the reference to the use of Administrative Summons. In this instance, reference to prior year tax returns or other readily available information may indicate that a sufficient examination may be completed by third-party contacts. In other instances, some indirect method of determining income may be necessary.

9 If a return is secured from the protester taxpayer, all related correspondence should be attached before forwarding (See IRM 4562).

10 When a return is not secured, a "Substitute for Return" should be prepared. (See IRM 4562.4) (See also 232.3 of IRM 48(13)1, AIMS—Use of Forms and Special Handling Procedures.)

11 Appeals procedures are available in tax controversies involving questions of fact or law. The Internal Revenue Service does not have authority to consider other grounds in administering the tax laws (See Rev. Proc. 68-12).

12 Consider referral for criminal prosecution under Section 7203, Willful Failure to File Return, Supply Information, or Pay Tax. In the event a criminal referral is not appropriate, serious consideration should be given to civil penalties.

13 Excessive Overstatement of Exemption, situations on Form W-4 will be handled in accordance with Manual Supplement 42G-382, "Establishment of Uniform Procedures to Detect and Correct Improper Use of Form W-4," dated July 31, 1978.

14 Vow of Poverty returns will be handled in accordance with procedures in IRM 4(13)29.

15 Family Estate Trust returns will be handled in accordance with procedures in IRM 426(26).

16 Penalties should be considered by the examiner and asserted, when appropriate. The determination will be made on a case-by-case basis. The facts and circumstances in each case will govern the imposition of a penalty. Guidelines to be used in the application of the negligence penalty imposed by IRC Section 6653(a) are found in IRM 4563.1. Examiners should not hesitate to recommend assertion of negligence penalty in appropriate cases.

Guidelines to be used in the application of the civil fraud penalty will be found in IRM 4563.41 and 4563.42. Examiners will recommend the civil fraud penalty only in cases where there is clear and convincing evidence proving the underpayment of tax was due to fraud. Careful scrutiny will be made by the review function to make certain that such penalities are asserted in appropriate cases.

17 Examiners will complete the Illegal Tax Protester Functional Report, Form 6178A, at the conclusion of the case. (See Section 5.026 of this Supplement.)

18 Examiners will prepare Form 3198 (Special Handling Notice) and place on front of protester case files on all cases requiring Collection activity, where the assessment meets the criteria in 213 of LEM V. Form 3198 will provide instructions for Centralized Services Branch as follows:

a. Request establishment of an open control base on IDRS.

b. Request for each period as follows:

(1) COMMAND CODE "ACTION"

(2) MFT

(3) TAX PERIOD ("e.g. 7812-7912")

(4) ACTIVITY CODE: TAX PROTEST

(5) STATUS CODE: B

(6) CATEGORY CODE: IRRQ

(7) Employee Assignment Number: DOAO 0044

c. Input unique "TSIGN" of DOAO 0044

d. Iuput Transaction Code TC 148 with entity indicator "0"

e. Copy Revenue Agents Report and workpapers and forward to the Collection Division Illegal Tax Protester Coordinator.

.04 *Collection Division Procedures*

1 The Chief, Collection Division will be responsible for ensuring quality processing of illegal tax protester cases and for designating a coordinator for the Division to control receipt and disposition of cases and complete necessary reports.

2 The coordinator will be responsible for:

a. Identifying and assigning cases;

b. Insuring that Criminal Investigation Division and Examination Division reports and workpapers are available for association with assigned TDA's, TDI's or RCP leads;

c. Coordinating with other divisions, and;

d. Completing program reports.

3 The following procedures apply to *Illegal Tax Protest TDI's and RCP Leads*:

a. Protest returns, which cannot be processed (see Section 5.031) will be evaluated for criminal prosecution potential by the service center Criminal Investigation Branch. Certain of these cases will be forwarded to the district Criminal Investigation Division for further inves-

tigation. Others, lacking criminal potential, will be forwarded to the service center Collection function. Cases declined for criminal investigation in the district will be forwarded to the district Collection Division Illegal Tax Protester Coordinator.

b. In each of these cases, the service center Criminal Investigation Branch will provide the following documentation:

(1) Copy of the tax protest document;

(2) IDRS history;

(3) Inquiry Letter 664 (SC) and taxpayer reply;

(4) Illegal Tax Protester Functional Report, and,

(5) Other related case history.

c. The service center Collection function will prepare Form 5488, Returns Compliance Lead, for these cases, attach related documentation, and transfer directly to the field Attn: Collection Division Illegal Tax Protester Coordinator. "Illegal Tax Protester" should be entered in block five of Form 5488.

4 The Collection Division Illegal Tax Protester Coordinator will assign RCP leads received from the service center(s) and have Form 5488 prepared and assigned in other cases received directly from the district Criminal Investigation Division. See Section 6.042 and 6.043 above. In every case, the coordinator should request Centralized Services Branch to input a Dummy Module for the taxpayer. Form 4844, Request for Terminal Action, will be prepared with the following information:

a. Input CC "ACTION" as follows:

(1) MF;

(2) TAX PERIOD(S); (e.g. 7812-7912)

(3) ACTIVITY CODE: TAX PROTEST

(4) STATUS CODE: B

(5) CATEGORY CODE: IRRQ

(6) ASSIGNMENT NUMBER DOA00044

(7) Input unique "TSIGN"—DOA00044

5 Certain instances of failure to file based on protest will be initially identified within the Collection activity in the normal course of working assigned cases. If the taxpayer indicates that the failure to file is based upon a protest outlined in Attachment 1, a Illegal Tax Protester Functional Report (Form 6178D) should be associated with the assigned TDA, TDI, or RCP lead and a copy of the assigned case should be submitted to the coordinator for control. The coordinator will advise the district Illegal Tax Protester Coordinator who will determine if the guidelines in this Supplement are applicable.

6 Revenue Officers should request input of TC 148 and request an open control base as outlined in Section 6.0318, but only if a delinquent return secured has an unpaid balance which meets the criteria in 213 of LEM V. Refusal to file situations and referrals to Examination Division will be handled as outlined in Manual Supplement 5G-48, dated November 21, 1977, and IRM 5140 with the following exceptions:

a. Every effort should be made to uncover sources of income. However, summons of a taxpayer's books and records for return preparation is *not recommended.*

b. Revenue officers should make every effort to locate and communicate with the taxpayer. However, referral to the Examination Division is not precluded if taxpayer contact cannot be made. If the taxpayer does not expressly indicate that he/she will not file but appears to be procrastinating, referral to the Examination Division may be made to expedite the case.

c. The entire case file, including information provided by the Criminal Investigation Division, should be attached to Form 3449, Referral Report, or Form 3212, Referral Report of Potential Fraud Case and forwarded to the coordinator. The coordinator should make and retain a copy of the file and then transfer the case to the Examination Division coordinator or Criminal Investigation coordinator, as appropriate.

7 When all delinquent returns investigations are closed, the Revenue Officer should request Centralized Services Branch to close the open control base.

8 *The following procedures apply to Illegal Tax Protester TDA's*:

a. Most protest TDA's will result from additional assessments made by the Examination Division. Such TDA's will be identified with the unique TSIGN—"DOA-00044." (See Section 6.0318 and 7.03). The Collection office function should note such accounts "Illegal Tax Protester" and assign them directly to a GS-11 or 12 Revenue Officer. However, before these accounts are transferred, they should be forwarded to the Collection Division Illegal Tax Protester Coordinator. The coordinator will retain a copy of the TDA for his/her file and attach whatever related data (e.g., prior RCP lead, Form 3449, Revenue Agents Reports, etc.) is available.

b. Revenue Officers must complete Illegal Tax Protester Functional Report (Form 6178D) on these accounts, as well as routine TDA's which through taxpayer contact, are identified as protest based on the criteria in Attachment 1. Revenue Officers must also send the Collection Division coordinator a copy of protest TDA's they identify. In these cases, the Collection Division Illegal Tax Protester Coordinator will advise the district Illegal Tax Protester Coordinator, who will determine if the guidelines in this Supplement are applicable to the TDA.

c. Normal collection procedures should be followed in these cases. However, when all TDA's are closed, the Revenue Officer should prepare Form 4844 to request Centralized Services Branch to input TC 149 to close the open control base.

9 Since some illegal tax protesters advocate violence in dealing with Service personnel, Revenue Officers should attempt to secure payments and returns without personally contacting the protester outside the office. If personal contact is necessary outside the office, the Revenue Officer should consider being accompanied by another Revenue Officer or armed escort.

10 Collection Division reporting requirements are as follows:

a. Returns secured in connection with this program should be identified by Secured Return Code (SRC) 26. (See IRM 5(14)42.)

b. Revenue Officers will submit to the Collection Division Illegal Tax Protester Coordinator a monthly

blotter record of "Illegal Tax Protester" casework as follows:

	TDA's	TDI's	RCP's
(1) Hours	—	—	—
(2) Units Rec'd	—	—	—
(3) Units Disposed			
(4) Referrals to Examination			
(5) Referrals to Criminal Inv.			

c. The Collection Division Illegal Tax Protester Coordinator will prepare the following report to be submitted on the 15th of the month following the calendar quarter to the National Office Collection Division, Attn: CP:C:MD, beginning with the quarter ending March 31, 1979 (Report symbol NO-CP:CI-62 controls this report)

	TDA's	TDI's	RCP's
(1) Protester Cases at Beginning of Quarter	—	—	—
(2) Protester Cases Rec'd during Quarter	—	—	—
(3) Protester Cases Closed During Quarter	—	—	—
(4) Protester Cases Open At End of Quarter	—	—	—
(5) Hours Spent	—	—	—
(6) Referrals to Examination	—	—	—
(7) Referrals to Criminal Inv.	—	—	—

.05 *Public Affairs*

1 The Public Affairs Officer should be fully informed, not just at that point in time when Criminal Investigation would normally coordinate with the Public Affairs Office, but when any protest activity might become public, i.e., EP/EO furnishes (or revokes) tax exemption of an organization. Also, if any function knows of a pend-

ing issue which may overlap from another district, the Public Affairs Office should be alerted. The disclosure laws, of course, apply to release of such information.

2 Managers and members of district speakers cadre should be alert to generally avoid situations that could result in a debate with protesters.

Section 7. Appeals Division Procedures

.01 Returns of Illegal Tax Protesters who request an appeals conference will be referred to the office of the Regional Director of Appeals and will be processed in accordance with the provisions of IRM 8200, on non-docketed cases, and IRM 8400, on docketed cases. Appeals will apply expeditious handling to such cases.

.02 Appeals Officers will prepare Form 3198 (Special Handling Notice) and place on the front of illegal tax protesters case files on all cases requiring Collection Activity, where the assessment meets the criteria in 213 of LEM V.

.03 A Form 3198 will provide instructions for Centralized Services Branch as follows:

1 Request establishment of an open control base on IDRS. Request for each period as follows:

a. COMMAND CODE: "ACTION"

b. MFT

c. TAX PERIOD: ("e.g., 7812-7912")

d. STATUS CODE: B

e. CATEGORY CODE: IRRQ

f. EMPLOYEE ASSIGNMENT NUMBER: DOA00044

2 Input unique "TSIGN" of DOA00044

3 Input Transaction Code TC 148 with entry indicator "0"

4 Copy Revenue Agents Report and workpapers and forward to the Collection Division Illegal Tax Protest Coordinator in the appropriate district

.04 On a quarterly basis, following information will be forwarded to the Director, Appeals Division, CP:AP within 20 workdays, beginning with the quarter ended March 31, 1979 (Report symbol NO-CP:Cl-62 controls this report.):

a. Protester return under consideration beginning of quarter

(1) Docketed

(2) Non-docketed

b. Protester Returns started during quarter

(1) Docketed

(2) Non-docketed

c. Protester Return closed during quarter

(1) Docketed

(2) Non-docketed

d. Protester returns under consideration at end of quarter

(1) Docketed

(2) Non-docketed

e. Technical Staff Time expended on protester cases during quarter

(1) Docketed

(2) Non-docketed

.05 Appeals officers will complete the Illegal Tax Protester Functional Report, Form 6178B, at the conclusion of the case. (See Section 5.026 of this Supplement.)

Section 8. Exempt Organizations Division Procedures

.01 The guidelines contained in Manual Supplement 7(10)G-19 Coordination of Examination of Certain Churches and Religious Orders and Related Individuals Returns, dated March 10, 1977, will be used by EO Examiners when dealing with so-called mail order ministries and church related issues.

.02 At the completion of an examination the Illegal Tax Protester Functional Report (Form 6178C) will be completed and the procedures outlined in Section 5.026 will be followed.

.03 A report will be furnished to the National Office on a quarterly basis, beginning with the quarter ended March 31, 1979, that will include the following information (Report symbol NO-CP:Cl-62 controls this report):

1 Number of organizations under examination and pre-examination

a. Beginning of Quarter

b. Started during Quarter

c. Closed during Quarter

d. Open at end of Quarter

2 Number of summonses issued

3 Number of summonses requiring enforcement actions

4 Time (hours)

a. District

b. Region

c. National Office

.04 The report should be forwarded to the Director, Exempt Organization Division (E:EO:O:P) within 20 workdays from the end of each calendar quarter.

Section 9. Coordination

.01 Service Center Directors are responsible for ensuring that the guidelines contained in this Supplement are implemented at the service centers. The service center illegal tax protester coordinator will establish coordination with the other functions to provide for the receipt and dissemination of information regarding the illegal tax protester area.

.02 District Directors are responsible for ensuring that all district functions are adhering to the guidelines contained in this Supplement. District Directors should establish procedures for obtaining information concerning district illegal tax protester activity.

1 District Illegal Tax Protester Coordinators (hereafter referred to as District Coordinators) are responsible for ensuring prompt processing of illegal tax protester information in accordance with Section 5 of this Supplement.

2 District Coordinators should establish coordination with appropriate district functions to develop a system for the receipt and dissemination of information regarding district illegal protester activities.

3 If appropriate, district coordinators should arrange for meetings with representatives of the other functions to discuss the illegal tax protester area as it affects the district. At a minimum, these meetings should be held on a quarterly basis.

.03 Regional Commissioners are responsible for ensuring that the districts in the region are effectively implementing the procedures contained in this Supplement.

1 Regional Illegal Tax Protester Coordinators should establish coordination with the appropriate functions to provide for the receipt and dissemination of information regarding regional illegal tax protester activities.

2 Regional Illegal Tax Protester Coordinators should arrange for meetings with representatives of the other functions to discuss the illegal tax protester area as it affects the region. At a minimum, these meetings should be held on a quarterly basis.

.04 The Assistant Commissioner (Compliance) through the Directors, Criminal Investigation, Examination, Collection, and Appeals Divisions will ensure that the regions are effectively implementing the guidelines contained in this Supplement.

1 The Director, Criminal Investigation Division, through the Illegal Tax Protester Coordinator, will act as a focal point for matters involving illegal tax protest activities. This will include maintaining the reports identified in this Supplement, and coordinating the analysis

to be performed on these reports; compiling the quarterly reports received from the other functions; assuring that the field is kept informed of significant occurrences in the illegal tax protester area (e.g., disseminating cases, new techniques, new procedures, etc.); and assuring that the data furnished to the Illegal Tax Protestor Activity Study Group will receive the appropriate analysis and disposition. The coordinator will also prepare a quarterly status report of illegal tax protester activity and forward this to the Assistant Commissioner (Compliance). This will include a summary of regional activity as well as other significant events in the illegal tax protester area. Information copies will be forwarded to all Regional Commissioners and Director of International Operations. The status report will be forwarded by the 15th day of the second month following the end of the calendar quarter. (Report symbol NO:CP:Cl-62 controls this report.)

2 The other National Office illegal tax protester coordinators will be responsible for monitoring illegal tax protester activities and compiling and analyzing data that has been forwarded by the regions. Additionally, they could be requested to assist in the analysis of the data furnished to the Illegal Tax Protester Activity Study Group. Each National Office Coordinator will provide pertinent data to the Criminal Investigation Division for incorporation into the report mentioned in 9.041, that will include statistical data regarding illegal tax protester activity and significant occurrences. This will be forwarded to the Criminal Investigation Division by the 7th day of the second month following the close of the calendar quarter. (Report symbol NO:CP:Cl-62 controls this report.)

Section 10. Distribution of Forms

An initial supply of the following new forms: 6178, 6178A, 6178B, 6178C, 6178D and 6179 will be automatically distributed to all Districts and Service Centers. A back-up supply will be maintained in the National Office Warehouse and can be requisitioned through Facilities Management using Form 16.

Section 11. Effect on Other Documents

.01 This supersedes Manual Supplement 9RDD-3, CR 41RDD-19, 42RDD-55, 45RDD-8, 5RDD-8, 7(10) RDD-1, and 81RDD-3, dated November 21, 1978.

.02 This supplements IRM 411(10); 4122; 4123; 4130; 4240; 426(26); 4414; 4460; 4562; 4563; 4634; 4720; IRM 5140; 5250; 5(11)61; 5(12)40; 5(18)54; 9820; and Exhibit 300-1 of IRM 9570. Case Management and Time Reporting System Handbook.

.03 This amends and supplements IRM 5(14)42.

.04 This supplements Chapter (13)00; Exhibits (13) 00-12 and (13)00-14 of IRM 4810, Audit Reports Handbook; and IRM 8100. This "effect" should be annotated by pen and ink on the Handbook text and Exhibits, and beside the basic text cited, with a reference to this Supplement.

.05 This supplements Manual Supplements 5G-48, CR 44G-79, 45G-292, and 47G-116, dated November 21, 1977.

.06 This supplements Manual Supplements 42G-382, CR 44G-82, 46G-22, 47G-121 and 5G-197, dated July 31, 1978.

.07 This also supplements Manual Supplement 7(10) G-19, dated March 10, 1977.

.08 The "effect" in .05 through .07 above should be annotated by pen and ink on the Supplements cited, with a reference to this Supplement.

NOTE: Copies of this Manual Supplement were distributed (before final review by the Internal Management Documents Division) to All Regional Commissioners. All Service Center Directors, All Assistant Commissioners, Chief Counsel, and Director, Public Affairs Division by memorandum from Assistant Director, Criminal Investigation Division, dated December 4, 1978.

/s/ W. E. Williams
Deputy Commissioner
Attachment

Illegal Tax Protester Scheme Definitions

1. *Constitutional Basis*—Refusal to include tax return information on Form 1040/1040A because of violation of Constitutional rights. In lieu of information required on Form 1040/1040A, the illegal tax protester either show "-0-," "none," "Object," or a Fifth Amendment annotation in all of the blanks or will include a broad general statement regarding his/her constitutional rights (including 4th Amendment and 16th Amendment). This is commonly referred to as a Porth/Daly type return.

2. *Fair Market Value*—Reducing gross income because of declining value of dollar. The gross income is listed on the face of the return and there is a large adjustment to income which makes adjusted gross income small enough for standard deduction to eliminate taxable income. The adjustment to gross income is on Schedule D, Schedule of Capital Gains and Losses, or Form 2106, Statement of Employee Business Expenses, for Form 1040.

3. *Gold/Silver Standard*—Any return with a statement that only gold or silver currency can be taxed.

4. *Blank Form 1040/1040A*—These generally fall into two categories. In one category the individual files a return with only a name and address, and possibly signature, and Form(s) W-2 is attached. This scheme is usually verified upon correspondence with the taxpayer.

In the second category the individual files a return similar to the Porth-type return, i.e., the lines contain "object," "Fifth Amendment," etc., with the exception that Form(s) W-2 is attached.

In both instances the return could or could not list marital status and/or exemptions.

5. *Non-Payment Protest*—Non-Payment or underpayment of tax based upon some type of protest statement written or attached to the return.

6. *Protest Adjust*—This is similar to Non-Payment Protest, in that the return contains specific unallowable items (e.g., deductions, exclusions, etc.) identified to some type of protest.

7. *Mail Order Ministries*—Individual receives income from non-religious sources and declares that it is non-taxable because of "vow of poverty." This scheme also involves returns where the individual includes all or substantially all of gross income as a contribution deduction on Schedule A of Form 1040. Some individuals will complete Form 1040 and then take an unusually large contribution deduction on Schedule A of Form 1040, normally 50% or more of adjusted gross income.

8. *Protester Letters and Cards*—The receipt of letters and cards (without tax return) protesting the use of taxes for war, defense and/or other government spending policies, and *indicating that this will effect their reporting and payment of taxes.*

9. *Family Estate Trust*—The trusts are filed on Forms 1041. Terms such as "family," "equity pure," "prime," or "constitutional" are used in the title of the trust. Income is from "wages" or "Contract" sources and deductions are for personal living expenses, such as housing, medical, auto, child care, interest or taxes. Generally, an individual will establish a trust, give his/her wages or other income to the trust and the trust pays for the expenses of the

individual. The expenses claimed as administrative expenses of the trust, resulting in the individual paying no tax and the trust paying little or no taxes.

10. *W4—Excessive Overstatement of Allowances*—This scheme is usually employed in conjunction with one of the other schemes mentioned above. The claiming of excessive allowances is usually directed towards eliminating of withholding of Federal taxes from wages.

11. *Forms 843 and Amended Returns*—Some individuals are filing Form 843 Claims and/or Amended Form 1040 (1040K) returns to obtain a total refund on all taxes paid in prior years, even though returns have not been filed for the prior years.

ITEM VII

UNITED STATES CODE

§ 7602. Examination of books and witnesses

For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

Aug. 16, 1954, c. 736, 68A Stat. 901.

ITEM VIII

UNITED STATES CODE

§ 7609. Special procedures for third-party summonses

(a) Notice.—

(1) In general.—If—

(A) any summons described in subsection (c) is served on any person who is a third-party record-keeper, and

(B) the summons requires the production of any portion of records made or kept of the business transactions or affairs of any person (other than the person summoned) who is identified in the description of the records contained in the summons,

then notice of the summons shall be given to any person so identified within 3 days of the day on which such service is made, but no later than the 14th day before the day fixed in the summons as the day upon which such records are to be examined. Such notice shall be accompanied by a copy of the summons which has been served and shall contain directions for staying compliance with the summons under subsection (b)(2).

(2) Sufficiency of notice.—Such notice shall be sufficient if, on or before such third day, such notice is served in the manner provided in section 7603 (relating to service of summons) upon the person entitled to notice, or is mailed by certified or registered mail to the last known address of such person,

or, in the absence of a last known address, is left with the person summoned. If such notice is mailed, it shall be sufficient if mailed to the last known address of the person entitled to notice or, in the case of notice to the Secretary under section 6903 of the existence of a fiduciary relationship, to the last known address of the fiduciary of such person, even if such person or fiduciary is then deceased, under a legal disability, or no longer in existence.

(3) Third-party recordkeeper defined.—For purposes of this subsection, the term "third-party recordkeeper" means—

(A) any mutual savings bank, cooperative bank, domestic building and loan association, or other savings institution chartered and supervised as a savings and loan or similar association under Federal or State law, any bank (as defined in section 581), or any credit union (within the meaning of section 501(c)(14)(A));

(B) any consumer reporting agency (as defined under section 603(d) of the Fair Credit Reporting Act (15 U.S.C. 1681a(f)));

(C) any person extending credit through the use of credit cards or similar devices;

(D) any broker (as defined in section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4)));

(E) any attorney; and

(F) any accountant.

(4) Exceptions.—Paragraph (1) shall not apply to any summons—

(A) served on the person with respect to whose liability the summons is issued, or any officer or employee of such person,

(B) to determine whether or not records of the business transactions or affairs of an identified person have been made or kept, or

(C) described in subsection (f).

(5) Nature of summons.—Any summons to which this subsection applies (and any summons in aid of collection described in subsection (c)(2)(B) shall identify the taxpayer to whom the summons relates or the other person to whom the records pertain and shall provide such other information as will enable the person summoned to locate the records required under the summons.

(b) Right to intervene; right to say compliance.—

(1) Intervention.—Notwithstanding any other law or rule of law, any person who is entitled to notice of a summons under subsection (a) shall have the right to intervene in any proceeding with respect to the enforcement of such summons under section 7604.

(2) Right to stay compliance.—Notwithstanding any other law or rule of law, any person who is entitled to notice of a summons under subsection (a) shall have the right to stay compliance with the summons if, not later than the 14th day after the

day such notice is given in the manner provided in subsection (a)(2)—

(A) notice in writing is given to the person summoned not to comply with the summons, and

(B) a copy of such notice not to comply with the summons is mailed by registered or certified mail to such person and to such office as the Secretary may direct in the notice referred to in subsection (a)(1).

(c) Summons to which section applies.—

(1) In general.—Except as provided in paragraph (2), a summons is described in this subsection if it is issued under paragraph (2) of section 7602 or under section 6420(e)(2), 6421(f)(2), 6424(d)(2), or 6427(h)(2) and requires the production of records.

(2) Exceptions.—A summons shall not be treated as described in this subsection if—

(A) it is solely to determine the identity of any person having a numbered account (or similar arrangement) with a bank or other institution described in subsection (a)(3)(A), or

(B) it is in aid of the collection of—

(i) the liability of any person against whom an assessment has been made or judgment rendered, or

(ii) the liability at law or in equity of any transferee or fiduciary of any person referred to in clause (i).

(3) Records; certain related testimony.—For purposes of this section—

(A) the term "records" includes books, papers, or other data, and

(B) a summons requiring the giving of testimony relating to records shall be treated as a summons requiring the production of such records.

(d) Restriction on examination of records.—No examination of any records required to be produced under a summons as to which notice is required under subsection (a) may be made—

(1) before the expiration of the 14-day period allowed for the notice not to comply under subsection (b)(2), or

(2) when the requirements of subsection (b)(2) have been met, except in accordance with an order issued by a court of competent jurisdiction authorizing examination of such records or with the consent of the person staying compliance.

(e) Suspension of statute of limitations.—If any person takes any action as provided in subsection (b) and such person is the person with respect to whose liability the summons is issued (or is the agent, nominee, or other person acting under the direction or control of such person), then the running of any period of limitations under section 6501 (relating to the assessment and collection of tax) or under section 6531 (relating to criminal prosecutions) with respect to such person shall be suspended for the period during which a proceeding, and appeals therein, with respect to the enforcement of such summons is pending.

(f) Additional requirement in the case of a John Doe summons.—Any summons described in subsection (c) which does not identify the person with respect to whose liability the summons is issued may be served only after a court proceeding in which the Secretary establishes that—

(1) the summons relates to the investigation of a particular person or ascertainable group or class of persons,

(2) there is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law, and

(3) the information sought to be obtained from the examination of the records (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.

(g) Special exception for certain summonses.—In the case of any summons described in subsection (c), the provisions of subsections (a)(1) and (b) shall not apply if, upon petition by the Secretary, the court determines, on the basis of the facts and circumstances alleged, that there is reasonable cause to believe the giving of notice may lead to attempts to conceal, destroy, or alter records relevant to the examination, to prevent the communication of information from other persons through intimidation, bribery, or collusion, or to flee to avoid prosecution, testifying, or production of records.

(h) Jurisdiction of district court.—

(1) The United States district court for the district within which the person to be summoned resides or is found shall have jurisdiction to hear and determine proceedings brought under subsections (f) or (g). The determinations required to be made under subsections (f) and (g) shall be made ex parte and shall be made solely upon the petition and supporting affidavits. An order denying the petition shall be deemed a final order which may be appealed.

(2) Except as to cases the court considers of greater importance, a proceeding brought for the enforcement of any summons, or a proceeding under this section, and appeals, take precedence on the docket over all cases and shall be assigned for hearing and decided at the earliest practicable date.

Added Pub.L 94-455, Title XII, § 1205(a), Oct. 4, 1976, 90 Stat. 1699, and amended Pub.L. 95-599, Title V, § 505(c)(6), Nov. 6, 1978, 92 Stat. 2760; Pub.L. 95-600, Title VII, § 703(*l*)(4), Nov. 6, 1978, 92 Stat. 2943; Pub.L. 96-223, Title II, § 232(d)(4)(E), Apr. 2, 1980, 94 Stat. 278.

ITEM IX

FEDERAL RULES OF CIVIL PROCEDURE

Rule 52. *Findings by the Court*

(a) *Effect.* In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 58; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b).

(b) *Amendment.* Upon motion of a party made not later than 10 days after entry of judgment the court may amend its findings or make additional findings and may amend the judgment accordingly. The motion may be made with a motion for a new trial pursuant to Rule 59. When findings of fact are made in actions tried by the court without a jury, the question of the sufficiency of the evidence to support the findings may thereafter be raised

whether or not the party raising the question has made in the district court an objection to such findings or has made a motion to amend them or a motion for judgment.

(As amended Dec. 27, 1946, eff. Mar. 19, 1948; Jan. 21, 1963, eff. July 1, 1963.)

Opposition

Office - Supreme Court, U.S.
FILED
MAY 17 1982
ALEXANDER L. STEVAS,
CLERK

No. 81-1836

In the Supreme Court of the United States

OCTOBER TERM, 1981

PAUL V. WATSON AND SHARON E. WATSON, PETITIONERS

v.

UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENTS IN OPPOSITION

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Solicitor General
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Washington, D.C. 20530
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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENTS IN OPPOSITION

In this internal revenue summons enforcement case, petitioners seek review of the decision below enforcing several summonses seeking information relevant to a tax investigation of petitioners.

The pertinent facts may be summarized as follows: As part of an investigation to determine petitioners' correct tax liabilities, the Internal Revenue Service issued summonses to six financial institutions and one accounting firm seeking information relevant to that investigation. Upon petitioners' direction to the summoned parties not to comply (see 26 U.S.C. 7609), the government instituted these consolidated proceedings in the United States District Court for the Southern District of Texas to enforce the summonses. Petitioners intervened and objected to enforcement of the summonses on the ground that they had been classified as tax protesters and thus the sole purpose of the special

agent's investigation was to prosecute them for their protest activities. They argued that Internal Revenue Manual Supplement 9G-93, entitled *Examination and Investigation of Illegal Tax Protest-type Activities* (Jan. 10, 1979),[1] evidenced an institutional abandonment of a civil tax determination purpose and a commitment to prosecute them (Answer to the enforcement petition, contained in the original record on appeal at Volume I, at 25).

At the enforcement hearing before the district court, Special Agent Ackley testified that the purpose of the investigation was to determine petitioners' civil tax liabilities and to investigate potential criminal violations of the Internal Revenue Code. He also stated that he had not made any recommendation regarding prosecution (Original Record, Volume 8 at 5, 6, 10-11, 12-14). On cross-examination, petitioners sought only to establish that Ackley was a criminal investigator and that in conducting his investigation he was following the guidelines of Manual Supplement 9G-93. They offered no evidence to controvert any of Agent Ackley's direct testimony.

The district court, looking only to the provisions of Manual Supplement 9G-93 and the fact that the special agent was conducting a criminal investigation, denied enforcement of the summonses on the ground that "the present posture of the I.R.S. is * * * solely a criminal one." The court further stated that "While it is possible that the I.R.S. may later abandon this criminal posture and seek civil tax liabilities, that fact does not change the present posture of this case, as set out in the Manual Supplement" (Pet. App. A-14 to A-15). In its supplemental memorandum,

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[1] Manual Supplement 9G-93, reproduced at Pet. App. A-19 through A-61, is unofficially *reprinted in* 6 Administration, CCH Internal Revenue Manual 29,295.

the court explained (Pet. App. A-9) that it denied enforcement because it believed that a summons may not be used by a special agent to conduct his criminal investigation.[2]

The court of appeals reversed. It recognized that under this Court's decision in *United States* v. *LaSalle National Bank*, 437 U.S. 298 (1978), the Internal Revenue Service "clearly may use its summons authority to aid in criminal investigations" (Pet. App. A-5 to A-6). Observing that *LaSalle National Bank* requires denial of enforcement of a special agent summons only when the Internal Revenue Service abandons its institutional commitment to pursue civil tax assessment and collection, the court of appeals found the uncontroverted testimony of the special agent to be sufficient to establish that no abandonment of such a civil tax purpose had occurred here (Pet. App. A-5 to A-6).

1. The court of appeals correctly upheld enforcement of the internal revenue summonses at issue in this case. In *United States* v. *Powell*, 379 U.S. 48, 57-58 (1964), this Court announced four requirements for the enforcement of an Internal Revenue summons. "[The Internal Revenue Service] must show that the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner's possession, and that the administrative steps required by the Code have been followed * * *." Subsequently, in *Donaldson* v. *United*

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[2]The district court issued a supplemental memorandum in order to dispose of petitioners' request for attorneys' fees and an injunction against the use of summonses to obtain information necessary for the conduct of the criminal investigation. The district court denied the injunction (Pet. App. A-9 to A-10), and awarded attorneys' fees (Pet. App. A-10 to A-13). The court of appeals did not specifically address the injunction, but did reverse the award of attorneys' fees, concluding that the district court had abused its discretion in awarding such fees (Pet. App. A-6).

States, 400 U.S. 517, 534-536 (1971), the Court held that the summons must be issued before the Internal Revenue Service recommends to the Department of Justice the initiation of a criminal prosecution relating to the subject matter of the summons. As the Court explained in *LaSalle National Bank, supra*, 437 U.S. at 311-314, the *Donaldson* holding is a prophylactic rule designed to protect the standards of discovery in criminal litigation and the role of the grand jury as a principal tool of criminal accusation. In elaboration of the *Donaldson* rule, the Court further held in *LaSalle National Bank* that the good-faith use of a summons requires that the Service not abandon its institutional responsibility to determine and to collect taxes and civil fraud penalties. That a single special agent intends only to gather evidence for a criminal investigation is not dispositive of the good faith of the Internal Revenue Service as an institution. "[T]hose opposing enforcement of a summons * * * bear the burden to disprove the actual existence of a valid civil tax determination or collection purpose by the Service" (437 U.S. at 316).

Petitioners apparently contend (Pet. 11-12) that Manual Supplement 9G-93 represents an institutional commitment to prosecute all tax protesters, to the exclusion of any civil tax assessment or collection purpose. But petitioners err in characterizing Manual Supplement 9G-93 as relating only to criminal investigations or requiring a recommendation for prosecution in every case. The Manual Supplement governs only initial decisions to investigate, and establishes uniform guidelines and procedures for the conduct of civil tax determinations, collections and administrative appeals (Pet. App. 40-54) as well as for the conduct of criminal investigations (Pet. App. 34-40). It does not direct that the pursuit of civil tax liabilities be abandoned, and "evidences no institutional commitment to prosecute * * *." *United States* v. *Pillsbury Credit Union*, 661 F. 2d 1195, 1197 (8th

Cir. 1981). Thus, there is no basis for petitioners' claim (Pet. 15-16) that the Manual Supplement is contrary to the principles established by this Court for the enforcement of internal revenue summonses.[3]

2. Petitioners also claim (Pet. 16-22) that the court of appeals impermissibly substituted its own findings of fact for those of the district court which were not found to be clearly erroneous. They further argue (Pet. 19-22) that the testimony of the special agent to which the court of appeals pointed as establishing a proper purpose for the investigation was inconsistent and uncorroborated. But the district court's determination that a summons may not be used to investigate criminal conduct was grounded on an incorrect legal standard and not on any testimony of the special agent, which the district court simply ignored. Since the district court applied an incorrect legal standard, the court of appeals was not constrained by the clearly erroneous standard. *LaSalle National Bank, supra,* 437 U.S. at 319, n.21; *United States* v. *Cortese,* 614 F. 2d 914, 920 (3d Cir. 1980). Moreover, the court of appeals' reliance on the agent's uncontroverted testimony that a valid tax determination purpose existed was plainly appropriate here where petitioners failed even to cross-examine the agent regarding his purpose. *United States* v. *Moon,* 616 F. 2d 1043, 1046 (8th Cir. 1980); *United States* v. *Freedom Church,* 613 F. 2d 316, 320 (1st Cir. 1979).

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[3]In this respect, petitioners (Pet. 14-15) confuse the *Powell* showing which the government must make to establish a prima facie case for enforcement, with their own "heavy" burden to show the existence of the "extraordinary" circumstance of the Internal Revenue Service's having abandoned its responsibility ultimately to assess and collect any taxes which may be determined to be due and owing. Contrary to the Court's decision in *LaSalle National Bank,* petitioners would require the government to establish affirmatively the existence of a valid civil purpose to its investigation.

3. Finally, petitioners err (Pet. 18-21) in arguing that the uncontradicted testimony of the special agent is insufficient to establish the *Powell* criteria and that some form of "written evidence" (Pet. 18) or other form of corroboration (Pet. 20-22) is necessary. This Court's statement in *LaSalle National Bank* that "examination of agent motive may be necessary to evaluate the good-faith factors of *Powell* * * *" (*id.* at 316 n.17) does not imply that an agent's testimony of a proper purpose is insufficient to rebut bare allegations of improper purpose. *United States* v. *Daffin*, 653 F. 2d 121, 123-124 (4th Cir. 1981). The decision below is consistent with *Daffin* and other precedent regarding the burden of proof.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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